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TRANSCRIPT OF RECORD

85796

Supreme Court of the United States

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 2, 1937.

CERTIORARI GRANTED OCTOBER 11, 1937.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

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MINNESOTA TEA COMPANY, PETITIONER,

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Pleas and proceedings in the United States Circuit Court of Appeals for the Eighth Circuit, at the March Term, 1937, of said Court, before the Honorable Kimbrough Stone, the Honorable Archibald K. Gardner and the Honorable Joseph W. Woodrough, Circuit Judges.

Attest:

E. E. KOCH,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

(Seal)

Be It Remembered that heretofore, to-wit: on the twenty-sixth day of September, A. D. 1936, a record on petition to review the decision of the United States Board of Tax Appeals was filed in the office of the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, in a certain matter wherein Guy T. Helvering, Commissioner of Internal Revenue, was Petitioner, and the Minnesota Tea Company was Respondent, which said record as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its Clerk, is in the words and figures following, to-wit:

a (Order Extending Time to File Record to October 1, 1936.)

United States Board of Tax Appeals.

Commissioner of Internal Revenue, Petitioner,
Docket No. 54227. vs.
Minnesota Tea Company, Respondent.

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Eighth Circuit, be and it is hereby extended to October 1, 1936.

CHARLES P. SMITH,
Member.

Dated: Washington, D. C., Aug. 24, 1936.

jd

Now, Sep. 24, 1936, the foregoing order enlarging time certified from the record as a true copy.

B. D. GAMBLE,
(Seal) Clerk, U. S. Board of Tax Appeals.

(Endorsed): Filed in the U. S. Circuit Court of Appeals, Eighth Circuit, on September 26, 1936. E. E. Koch, Clerk.

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1 Docket Entries.

Minnesota Tea Company, Petitioner,
Docket No. 54227. vs.
Commissioner of Internal Revenue, Respondent.

Appearances.

For Taxpayer: J. Marvin Haynes, (withdrawn) C. J. McGuire, Esq., James S. Nye, Esq., Oscar Mitchell, Esq., Homer Hendricks, Esq.

For Comm'r.: G. D. Brabson, Esq., Prew Savoy, Esq.

1931
Mar. 20—Petition received and filed. Taxpayer notified. (Fee paid)

" 21—Copy of petition served on General Counsel.

Apr. 25—Answer filed by General Counsel.

May 2—Copy served—assigned to General Calendar.

1932
Sep. 21—Hearing set Oct. 12, 1932.

Oct. 12—Hearing had before J. M. Sternhagen, Div. 10. Submitted on the merits. Stipulation of facts and attached exhibits filed. Briefs due Nov. 22, 1932—December 1, 1932 for reply. Exchange by counsel.

" 19—Transcript of hearing of Oct. 12, 1932 filed.

Nov. 22—Brief filed by taxpayer. Copy served 11/23/32.

" 22—Brief filed by General Counsel.

" 30—Motion for extension for 10 days to file reply brief filed by taxpayer. 11/30/32 granted.

Dec. 12—Reply brief filed by taxpayer.

1933
Jun. 30—Opinion rendered, John M. Sternhagen, Div. 10. Judgment will be entered under Rule 50.

Jul. 29—Motion for rehearing filed by General Counsel. 8/1/33 granted.

Sep. 1—Motion to set aside order granting respondent's motion for rehearing filed by taxpayer. 9/29/33 denied.

Sept. 29—Memorandum to accompany denial of motion of petitioner (filed Sept. 1, 1933) filed.

Oct. 17—Rehearing set Nov. 8, 1933.

Oct. 25—Motion for leave to amend answer, amendment tendered, filed by General Counsel. 10/27/33 granted.

Oct. 26—Motion to refer to full Board, Judge Sternhagen's decision on petitioner's motion, filed by taxpayer.

Nov. 7—Order denying taxpayer's motion of 10/26/33 entered.

Nov. 8—Hearing had before Mr. Sternhagen on rehearing—respondent closes on rehearing. Petitioner moves for judgment as per deficiency notice—denied. Statement of recomputation petitioner has been served by respondent—no contest—Judgment will be entered.

2

Nov. 13—Judgment entered, J. M. Sternhagen, Div. 10.

Nov. 14—Transcript of hearing of Nov. 8, 1933 filed.

1934

Feb. 5—Notice of withdrawal of J. Marvin Haynes and appearance of Oscar Mitchell as counsel filed.

Feb. 5—(1) Petition for review by United States Circuit Court of Appeals, 8th Circuit, with assignments of error filed by taxpayer.

Feb. 5—(1) Proof of service filed by taxpayer.

Mar. 10—Praecipe with proof of service thereon filed.

Mar. 20—Copy of order from 8th Circuit, directing transcript of proceedings to be incorporated into transcript, filed.

April 5—Order enlarging time to May 15, 1934 for transmission and delivery of record, sur petition for review, entered.

May 2—Mandate from United States Circuit Court of Appeals, 8th Circuit, reversing Board's decision filed.

May 6—Order that parties proceed forthwith as under Rule 50, in order that mandate shall be made effective, and a judgment entered pursuant thereto, entered.

May 15—Order enlarging time to July 2, 1934 for transmission and delivery of record sur petition for review, entered.

May 23—Motion that action in this proceeding be delayed until action on writ of certiorari is made, filed by taxpayer.

June 7—Motion to rescind order dated May 6, 1935 filed by taxpayer.

June 15—Transcript of record sent clerk U. S. Circuit Court of Appeals, St. Louis, Missouri.

1935

Dec. 30—Memorandum rendered, J. M. Sternhagen, Div. 10, that it is unnecessary to set case for hearing, pending stipulation, petitioner's Brief due 1/30/36. Respondent's 2/17/36.

1936

Jan. 20—Motion to put down for oral argument and for continuance to file briefs. An extension of 10 days for petitioner's brief after the date of oral argument and 20 days after date of argument for respondent's brief, filed by taxpayer.

Jan. 20—Notice of the appearance of Homer Hendricks counsel for taxpayer.

Jan. 21—Motion of Jan. 20, 1936, to change time for filing briefs denied. Oral argument granted, Feb. 20, 1936.

Jan. 28—Brief filed by taxpayer. 1/29/36 copy served.

Feb. 3—Copy of order from 8th Circuit ordering Mandate of Supreme Court (affirming judgment of this Court) be filed and spread upon record of this Court and transmitted to Board, filed.

Feb. 14—Supplemental brief filed by General Counsel.

Feb. 18—Notice of the appearance of James G. Nye, counsel for taxpayer.

Feb. 20—Hearing had before Mr. J. M. Sternhagen, Div. 10. Submitted on oral argument pursuant to Opinion and Mandate of Supreme Court.

3

Feb. 24—Transcript of hearing of 2-20-36 filed.

Mar. 18—Opinion rendered, Mr. J. M. Sternhagen, Div. 10. Judgment will be entered under Rule 50.

Mar. 30—Order correcting opinion as to one word, entered.

Apr. 6—Notice of settlement filed by General Counsel.

Apr. 8—Hearing set Apr. 29, 1936, under Rule 50.

Apr. 17—Consent to settlement filed by taxpayer.

Apr. 18—Judgment entered, Mr. J. M. Sternhagen, Div. 10.

Jul. 3—Petition for review by United States Circuit Court of Appeals, 8th Circuit, with assignments of error filed by General Counsel.

July 6—Proof of service filed by General Counsel.

July 16—Proof of service filed by General Counsel.

Aug. 24—Motion for extension to 10/1/36 to prepare and transmit record filed by General Counsel.

Aug. 24—Order enlarging time to 10/1/36 to prepare and transmit record, entered.

Aug. 31—Praecipe filed with proof of service thereon.

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4 (Petition of Minnesota Tea Company for Appeal.)

(Filed March 20, 1931. U. S. Board of Tax Appeals.)

United States Board of Tax Appeals.

Minnesota Tea Company, Petitioner,
Docket No. 54227. vs.
Commissioner of Internal Revenue, Respondent.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:D-3; SON-60D) dated January 26, 1931, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at 2023 West Superior Street, Duluth, Minnesota.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on January 26, 1931.

3. The taxes in controversy are income taxes for the year 1928 and in the amount of $11,587.64.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

The respondent has erroneously included in taxable income an amount of $106,471.73 representing an alleged profit realized from the transfer of petitioner's assets in a reorganization.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

5 (a) On August 23, 1928, in pursuance of a plan of reorganization, petitioner transferred all of its assets to Grand Union Company and received in exchange therefor 18,000 shares of common stock of said Grand Union Company plus $426,842.52 in cash.

(b) Petitioner in pursuance of the plan of reorganization, immediately distributed all of the cash to its stockholders.

(c) Petitioner's stockholders assumed liabilities of the corporation amounting to $106,471.73.

(d) Respondent has added to petitioner's taxable income an amount of $106,471.73, representing an alleged profit realized by the petitioner upon the above transfer of assets.

(e) If the amount of $106,471.73 is excluded from petitioner's taxable income, petitioner sustained a net loss for the year 1928.

6. Wherefore, the petitioner prays that this Board may hear the proceeding and

(a) Exclude from petitioner's taxable income the amount of $106,471.73.

(b) Disallow the deficiency of $11,587.64.

(c) Afford such further relief as the nature of the case may require and to the Board may seem equitable and proper.

J. MARVIN HAYNES,
Counsel for Petitioner,
916 Investment Bldg.,
Washington, D. C.

Of Counsel:
Lybrand, Ross Bros. & Montgomery,
C. J. McGuire,
W. C. Magathan.

Dated, March 18, 1931.

6 State of Minnesota,
County of St. Louis—ss.:

E. C. Peterson, being duly sworn, says that he is president of Minnesota Tea Company, and is duly authorized to verify the foregoing petition; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

E. C. PETERSON.

Subscribed and sworn to before me this 18th day of March, 1931.

(Seal)

S. H. ECKMAN,
Notary Public.

7 Exhibit A.

Treasury Department
Washington

January 26, 1931.

Office of
Commissioner of Internal Revenue

Minnesota Tea Company,
2023 West Superior Street,
Duluth, Minnesota.

Sirs:

In accordance with the provisions of section 273(a) of the Revenue Act of 1928, there has been assessed against you an income tax amounting to $11,587.64 for the taxable period January 1, 1928 to August 24, 1928, the details of which are set forth in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given to the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

Respectfully,

DAVID BURNET, Commissioner,
By J. C. Wilmer.

Enclosures:
Statement
Schedule

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8 Statement

IT:AR:D-3
SON-60D

In re: Minnesota Tea Company
2023 West Superior Street,
Duluth, Minnesota.

Tax Liability

Period	Correct Tax Liability	Tax Previously Assessed	Deficiency
January 1, 1928 to August 24, 1928	$11,587.64	None	$11,587.64

Reference is made to the report of the internal revenue agent in charge, St. Paul, Minnesota disclosing no change in your tax liability for the period indicated.

You are advised that this office may not approve the recommendation of the agent in charge, of which you were advised under date of August 25, 1930 that your return for the period ended August 24, 1928 be accepted as correct.

The reasons for this action are as follows:

This office holds that a taxable profit resulted to the Minnesota Tea Company from the disposition of its assets and business on August 23, 1928 to the Grand Union Company in exchange for stock of the latter and a sum in cash, whereas the examining officer held that the transaction was a reorganization under section 112 (i) (1) (B) of the Revenue Act of 1928 and resulted in no gain or loss to the Minnesota Tea Company or the Peterson Investment Company.

The facts in the case show that prior to such disposition of its assets, the Minnesota Tea Company formed, or caused to be formed, the Peterson Investment Company, and on July 14, 1928, certain assets were transferred by your corporation to the latter corporation in exchange for the entire capital stock of the latter. The assets so transferred to the newly formed corporation consisted of real estate and buildings, investments, and certain other assets. Immediately upon receipt of such stock by your corporation it was distributed pro rata among its stockholders.

The remaining assets in the Minnesota Tea Company were transferred to the Grand Union Company on August 23, 1928, in exchange for 18,000 shares of common stock in said Grand Union Company and a payment in cash in the amount of $426,842.52. The aforesaid 18,000 shares of common stock in the Grand Union Company constituted less than a majority of the outstanding shares of stock in said company. The following resolution was adopted at a special meeting of the stockholders of the Minnesota Tea Company held on August
9 22, 1928, with respect to the disposition of the aforesaid cash received by said company:

"Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so dis-

tribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company whether due and payable or not and whether certain or contingent."

The facts at hand show that the Minnesota Tea Company owed debts amounting to $106,471.73 and that on August 23, 1928 it distributed the first cash received through the following journal entry:

"Dr.	Reserve for Appreciation of Goodwill	$256,348.90	
	Notes payable	25,000.00	
	Accounts payable	73,918.46	
	A. F. Peterson	130.58	
	L. T. Peterson	1,613.74	
	E. C. Peterson	4,779.78	
Cr.	Cash		$361,791.46

"To record distribution to stockholders in accordance with plan of reorganization adopted and ratified at meeting of the stockholders on 8/22/28 of the cash received and assumption of the liabilities by the stockholders in accordance with agreement.

"From this it will be noted that the stockholders accounts payable were paid in cash by the corporation through the above journal entry, and the balance of the liabilities were paid by the stockholders after the above distribution.

10 "There is a difference of $1,029.17 between the total liabilities above and the amount of $106,471.73 which was adjusted at the time the balance of the sale price of $426,842.52 was received."

From the foregoing, it is to be assumed that the entire amount of cash received by the Minnesota Tea Company from the Grand Union Company was distributed to the stockholders in the Minnesota Tea Company, who paid the debts of said latter corporation out of the moneys received, said stockholders retaining out of said moneys the following amounts in their capacity as creditors of said corporation:

A. F. Peterson	$ 130.58
L. T. Peterson	$1,613.74
E. C. Peterson	$4,779.78

After the distribution of the cash received from the sale of its assets, the Minnesota Tea Company had nothing on its books except the stock in the Grand Union Company. The corporate structure of the Minnesota Tea Company had not changed. It is still a going concern, and its stock is held by the same persons as before the sale.

With reference to the transfer of a portion of its assets to the Peterson Investment Company, since the Minnesota Tea Company or its stockholders or both were in complete control of the transferee immediately after the transfer, said transaction clearly constituted a reorganization under section 112 (i) (1) (B) of the Revenue Act of 1928, to which both of said corporations were parties. No taxable gain resulted to the Minnesota Tea Company from this transaction under section 112 (b) (4) of the Revenue Act of 1928. No gain was recognized to the stockholders in the Minnesota Tea Company under section 112 (g) of the aforesaid act. No gain was recognized to the Peterson Investment Company, said transaction being regarded as a purchase from the standpoint of said company. The cost or other basis of the stock in the Minnesota Tea Company to the stockholders therein should be allocated or apportioned between that stock and the stock in the Peterson Investment Company, in the ratio or proportion of the respective values thereof as of the effective date of the distribution to the stockholders of the stock in the latter, as provided in article 600 of Regulations 74, as amended by Treasury Decision 4274, Cumulative Bulletin VIII-2, page 240. Under section 112 (a) (7) of the 1928 Act the basis of the assets transferred by the Minnesota Tea Company to the Peterson Investment Company is the same as said assets had in the hands of the Minnesota Tea Company.

11 Minnesota Tea Company.

Schedule 1.

Net loss reported on return	($9,908.07)
Additional income:	
Profit on disposition of assets	106,471.73
Net income adjusted	$ 96,563.66

Explanation of Changes

For details see statement.

Schedule #2.

Computation of Tax.

Net income adjusted	$96,563.66
Tax at 12%	11,587.64
Tax previously assessed	none
Deficiency in tax	$11,587.64

12 With reference to the transfer of the remaining assets to the Grand Union Company on August 23, 1928, it is to be noted that said assets constituted all the properties then owned by the Minnesota Tea Company. Said transfer, therefore, falls within the definition of a reorganization as set out in section 112 (i) (1) (A) of the 1928 Act in that it was the acquisition by one corporation of all the properties of another corporation. Both the Minnesota Tea Company and the Grand Union Company were parties to said reorganization. General Counsel's Memorandum 3827, Cumulative Bulletin, VII-2, page 114.

The Minnesota Tea Company, having distributed the entire $426,842.52 cash received by it to its stockholders in the manner hereinabove related, the question is presented, whether such distribution, to the extent that said money was used to pay the corporate debts in the amount of $106,471.73, including the debts of said corporation to its stockholders, fall within the meaning of the word "distribute" as it is used in section 112 (d) (2) of the 1928 Revenue Act. To the extent that the stockholders were required to pay the corporate debts out of such money, they clearly could not be taxed on such income, nor would the basis of their stock be affected. Such distribution redounded to the benefit of the corporation as much as if the corporation itself had paid its corporate debts out of said cash received, and distributed the balance to its stockholders as ordinary or liquidating dividends.

The effect of using the money to pay the corporate debts, whether paid directly by the corporation to the creditors, or by the corporation to its stockholders who in turn paid the creditors, would be to increase the value of the corporate property to the extent of the debts paid. In other words, the corporation, from an economic standpoint, would retain the benefit of the cash received just as if it had kept said cash and left its debts outstanding. The Bureau has, heretofore, taken the position that the word "distribute" does not include a distribution to creditors. This being true, it seems to logically follow that a distribution to stockholders for the benefit of creditors falls within the same category.

In the light of the foregoing it is the opinion of this office that the word "distribute" as used in section 112 (d) (2) of the 1928 Act can reasonably and should be interpreted to mean a distribution to stockholders to be used for their own benefit, and not a distribution to or for the benefit of creditors, and that the Minnesota Tea Company did not distribute the cash received by it to the extent of the amount of its debts, namely, $106,471.73, within the meaning of section 112 (d) (2) of the 1928 Act.

13 The basis of the assets transferred by the Minnesota Tea Company to the Grand Union Company was $199,016.09, taxable gain in the amount of $106,471.73 was realized by the Minnesota Tea Company as a result of the transaction between it and the Grand Union Company, under the provisions of section 112 (d) (2) of the 1928 Revenue Act. The basis of the stock in the Grand Union Company in the hands of the Minnesota Tea Company must be determined under section 113 (a) (6) of the Revenue Act of 1928. No gain or loss was recognized to the Grand Union Company, the transaction being regarded as a purchase from the standpoint of said company.

In view of the fact that there has been a transfer of your assets, the Bureau will be unable to afford you an opportunity under the provisions of article 1211 of Regulations 69 and/or article 451 of Regulations 74 to discuss your case before mailing formal notice of its determination as provided in sections 274 and 279 of the Revenue Act of 1926 and/or sections 273 and 274 of the Revenue Act of 1928 and it is, therefore, necessary at this time in order that the interests of the Government may be protected to issue this formal notice of deficiency.

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14 (Answer of Commissioner of Internal Revenue.)

(Filed April 25, 1931, United States Board of Tax Appeals.)

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer admits, alleges and denies as follows:

1 and 2. Admits the allegations of paragraphs 1 and 2 of the petition.

3. Alleges that the notice of deficiency dated January 26, 1931, sets forth a deficiency in income tax amounting to $11,587.64 for the period January 1, 1928 to August 24, 1928.

4. Denies the allegations of paragraph 4 of the petition, and further denies that the respondent erroneously determined the tax liability of the petitioner for the said period.

5. (a) to (e), inclusive. Denies any knowledge or information sufficient to form a belief as to the truth of the allegations of paragraphs 5 (a) to (e), inclusive, of the petition, and therefore denies the same.

6. Denies generally and specifically each and every allegation of the petition not hereinbefore admitted or denied.

Wherefore, it is prayed that the appeal be denied.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

Hartford Allen,
Special Attorney,
Bureau of Internal Revenue.

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15 (Opinion of United States Board of Tax Appeals.)

United States Board of Tax Appeals.

Minnesota Tea Company, Petitioner,
Docket No. 54227. vs.
Commissioner of Internal Revenue, Respondent.

Promulgated March 18, 1936.

A corporation exchanged its assets in a statutory reorganization for shares of the transferee corporation and money, and immediately distributed all the money pursuant to a resolution which provided that the shareholders should assume the corporate debts. The shareholders discharged the corporate debts. Held, that the money thus received must be regarded as entirely distributed to shareholders and no part thereof may be regarded as recognizable gain of the corporation.

James G. Nye, Esq., and Homer Hendricks, Esq., for the petitioner.

George D. Brabson, Esq., for the respondent.

Opinion.

STERNHAGEN: In this proceeding, the Board, in Minnesota Tea Co., 28 B. T. A. 591, held, upon the stipulated facts, that there was no statutory reorganization, and this decision pre-

cluded consideration of the taxpayer's contest of the Commissioner's original determination of deficiency. The Board's decision was reversed, Minnesota Tea Co. vs. Commissioner, 76 Fed. (2d) 797; Helvering vs. Minnesota Tea Co., ... U. S. ..... (December 16, 1935). The proceeding is now here under mandate for consideration of the original issue.

The question is whether gain is to be recognized to the extent of $106,471.73 of the cash received, that being the amount of the corporate debts which were assumed and discharged by the shareholders. In 1928 the petitioner, in the statutory reorganization, transferred its assets to the Grand Union Co. for 18,000 shares of Grand Union stock and $426,842.52 money. The corporation was committed, by a resolution adopted the preceding day, to turn over the money immediately to its shareholders. The resolution is as follows:

Resolved further that all moneys received by Minnesota Tea Company on such sales of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stock-
16 holders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company whether due and payable or not and whether certain or contingent.

The money was turned over to the shareholders. The corporate debts amounted to $106,471.73. The evidence does not contain the written agreement required by the resolution, but it is stipulated that the amount of the liabilities was assumed and discharged by the shareholders.

The petitioner contends that immediately upon the receipt of the Grand Union shares and the $426,842.52, it distributed the money in pursuance of the plan of reorganization, and that the situation is squarely within section 112 (d) (1), Rev-

enue Act of 1928,[1] providing that "no gain shall be recognized." The respondent urges that the shareholders' assumption of the corporate debts prevents the amount of $106,471.73 from being regarded as a distribution by the corporation, and hence that it may not escape recognition as part of the corporation's gain.

Taking the resolution at its face, it provides for two things: (1) the "distribution" to the shareholders of all the money received in the reorganization, and (2) an "agreement" by the shareholders to pay the corporate debts. Both were carried out. Apparently neither the terms of the resolution nor the actual conduct of the parties justifies treating these promises as condition one upon the other. Jacob & Youngs, Inc. vs. Kent, 230 N. Y. 239; 129 N. E. 889; Restatement of the Law, Contracts, § 261; Williston on Contracts, § 665. The legal effect of a dividend resolution which embodies such a shareholders' promise is not clear, cf. Lindgrove vs. Schluter & Co., 256 N. Y. 439; 176 N. E. 832;
17 Thomas vs. Matthews, 94 Ohio St. 32; 113 N. E. 669, but even if we treat the relation between the petitioner and its shareholders as if it were contractual, there is no reason to say that the failure of the shareholders to perform the promise would avoid or rescind the distribution. The corporation was not liquidating, and it had assets consisting of the 18,000 shares of Grand Union stock plus $426,842.52 in cash (approximately $966,000), entirely ample to justify a dividend of $426,842.52 and payment of its debts of $106,471.73, Clarence LeBus, 1 B. T. A. 733; cf. O. B. Barker, 3 B. T. A. 1180. Under these circumstances, breach of the shareholders' promise would give the corporation no more than (if as much as) a remedy in damages. This would leave the dividend unaffected as to character or amount.

The Government argues that, of the distribution, $106,471.73 must be regarded as charged with the payment of the debts, or as a trust fund appropriated to that purpose, and that in neither event is it, properly speaking, a distribution.

---

[1] Sec. 112. Recognition of Gain or Loss.

* * * * * * *

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

* * * * * * *

The corporation, until the actual discharge of its debts, remained the primary debtor. No attempt was made to secure the consent of the creditors to a substitution of obligor. The corporation continued to own the 18,000 Grand Union shares, worth over $500,000. What then is the foundation for a trust? Ordinary legal remedies were available for the ample protection of all parties. The corporation was neither liquidating nor impoverishing itself. Its liability persisted until payment. There was no occasion, either as to the corporation or as to the shareholders, for a trust. Against the shareholders, the corporation had, if there was a juristic promise, a remedy at law if they failed to pay the debts. The shareholders, upon the receipt of the $426,842.52 cash, had the right to use it as they chose and to fulfill their promise to the corporation in any way they might elect, without being required to use the distribution to pay the debts. If, indeed, the shareholders were able by negotiation to discharge the debts for less than their book or face value, they were still entitled to retain the amount of the distribution.

The regulations adopted pursuant to the Revenue Act of 1928 deal no more specifically with the present state of facts than does the statute itself, nor is any light to be derived from the Congressional reports as to the Revenue Bill of 1924, which first carried the statutory provision, i. e., Revenue Act of 1924, section 203 (e) (H. R. rept. No. 179, Committee on Ways and Means, 68th Cong., 1st sess. p. 15; and S. rept. No. 398, Committee on Finance, 68th Cong., 1st sess. p. 16). When considering the changes proposed from the existing Revenue Act of 1921, the House Committee on Ways and Means had before it a statement by A. W. Gregg, special assistant to the Secretary of the Treasury,[2] which illuminates the intendment of the act finally passed, and indicates that since the petitioner was in fact "a

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[2] Sec. 203 (e): There is no provision of the existing law which corresponds to subdivision (e) of the bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization transfers its assets to another corporation, a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss to the transferor is recognized, if it distributes the cash to its stockholders. But if the selling corporation fails to distribute the cash to its stockholders then the gain or loss is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is to be recognized, but if it retains the entire amount of proceeds with the result that the transaction is in substance a real sale, then the gain shall be recognized.

A corporation in connection with a reorganization may dispose of its assets in one of three ways: It may transfer them to a new corporation in exchange for stock or cash; it may transfer them to the new corporation, the consideration being the payment by the new corporation of stock or cash to the stockholders of the old corporation; or the new corporation may buy, with its stock and cash,

mere conduit'' through which the money passed from the Grand Union Co. to the shareholders, any gain to the petitioner which it embraced should escape recognition. Argument is presented to establish that this legislative history justifies a construction broad enough to include a distribution among creditors as well as among shareholders. This view has its advocates,[3] but it is not necessary that it be directly decided in this proceeding, for, as we have seen, the petitioner did not provide for or make a distribution among its creditors and did not secure from its creditors a release from its obligations. When a corporation used money thus received in a reorganization for the purpose of directly discharging its bonded indebtedness, it was held that such use was not a statutory distribution. Liquidating Co., 33 B. T. A.— (No. 174). But the proposition that the corporation's direct payment to its bondholders is not a statutory distribution does not carry the corollary that the shareholders' promise to discharge the corporation's current debts had the same effect, and changes the distribution made to them into a discharge by the corporation of its debts, converting, so
19 to speak, the actual distribution pro tanto into a constructive nondistribution.

The Government urges that since the Tea Co. in fact had a gain of $712,195.90 (see 28 B. T. A. 591), all of which would be taxable but for the special statutory provisions for nonrecognition, the nonrecognition may only extend to cases clearly within the statute, and that the taxpayer is charged with the burden of bringing himself within the nonrecognition provision. This is a correct general statement (Sarther Grocery Co., 22 B. T. A. 1273; affd., 63 Fed. (2d) 68; Arctic Ice Machine Co., 23 B. T. A. 1223; 67 Fed. (2d) 983; Edison Securities Corporation, 29 B. T. A. 483; 78 Fed. (2d) 85). Liter-

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from the stockholders of the old corporation their stock and then liquidate the old corporation. If a corporation adopts the first method, its gain from the sale could be taxed. If it adopts the second method, the gain probably could be taxed on the theory of constructive receipt by the selling corporation. If it adopts the third method, there is no theory on which any gain to the old corporation could be taxed. As a result of these considerations, subdivision (e) has been so drafted that the tax liability on the selling corporation is the same no matter which of the three methods set out above is adopted. In other words, if the selling corporation is a mere conduit through which the consideration for the sale of the assets passes, or if the consideration for the sale of the assets is paid direct to the stockholders of the old corporation, without passing through the conduit, no gain or loss to the old corporation is recognized, and the same result is reached that would have to be reached necessarily if the transaction were accomplished through the medium of a purchase by the new corporation of the stock of the old corporation followed by a liquidation of the old.

[3] Paul and Mertens, Law of Federal Income Taxation, Vol. 2, § 17,102;
Miller, Reorganizations and Other Exchanges in Income Taxation, § 134;
Montgomery, Federal Income Tax Handbook, 1935-1936, p. 202;
Cf. Baar and Morris, Hidden Taxes in Corporate Reorganizations, ch. 12, § 15.

ally, however there was an express distribution of all the money among the shareholders, and it is the respondent who seeks to depart from the recognition of the facts and to call the actual distribution which was made a constructive payment of corporate debts. It can not readily be said that to avoid recognition of the gain is contrary to any purpose manifest in the statute. The dominating purpose of the reorganization provisions of the statute is elusive. It is far from clear enough to prevent the recognition of an express distribution because it has the effect of lowering the corporation's tax.

Reviewed by the Board.

Judgment will be entered under Rule 50.

ARUNDELL, dissenting: The question in this case is whether the petitioner meets the provisions of section 112 (d) (1) of the Revenue Act of 1928 to the extent of $106,471.73 of the cash received by it from the Grand Union Co., which was the amount of the corporate debts assumed and discharged by the petitioner's stockholders. The majority opinion holds that it does. I cannot agree with that holding.

First: The recent case of the Liquidating Co., 33 B. T. A. —(No. 174) decides directly against the suggestion that a distribution among creditors may come within the statute, holding that cash received in a reorganization and used to redeem the taxpayer's debentures was not distributed within the meaning of the cited section. To the same effect is West Texas Refining & Developing Co. vs. Commissioner, 68 Fed. (2d) 77.

Second: If the above proposition is sound, there would not be a different rule where the corporation turns the money over to others to use to pay its debts. Whatever the legal relation of the recipients to the taxpayer, they would be liable for payment of the debts at the instance of the creditors. Lawrence vs. Fox, 20 N. Y. 268; Hendrick vs. Lindsay et al., 93 U. S. 143. Their liability in this respect would not
20 depend on the solvency or insolvency of the taxpayer nor upon whether or not the liability of the taxpayer persisted. I think it a misconstruction of the provisions of the resolution to say that the distribution by the corporation and the agreement by the stockholders to assume the debts were not conditioned upon each other. The part of the resolution quoted consists of one sentence. In the first part it is resolved "that all money * * * be immediately distributed * * * upon the assumption by the stockholders of all the corporate debts." In the second part the directors are au-

thorized and directed to distribute the money accordingly and to enter into an agreement with the stockholders whereby the stockholders "in consideration of such distribution * * * agree to pay all the corporate debts." To me it seems clear from this language that the distribution is expressly conditioned upon the assumption of the corporate debts by the stockholders and they took the distribution subject to this condition. A dividend resolution "is to be taken as it emanates from the board. A part of it cannot be taken and the rest discarded." State vs. B. & O. R. R., 6 Gill (Md.) 363, 386, quoted in General Utilities & Operating Co., 29 B. T. A. 934; affd., ... U. S. ..... Thus, in the final analysis the petitioner merely used its stockholders as a conduit for payment of its debts, and gain realized and used for this purpose cannot escape tax under the reorganization provisions of the statute. Liquidating Co., supra.

BLACK, MCMAHON, TURNER, MELLOTT, and ARNOLD agree with this dissent.

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21 Order Correcting Opinion.

United States Board of Tax Appeals
Washington

Minnesota Tea Company, Petitioner,
Docket No. 54227. vs.
Commissioner of Internal Revenue, Respondent.

To correct an error, it is

Ordered that the opinion promulgated March 18, 1936, be and hereby it is corrected by inserting in the sixth paragraph, the fifth sentence, the word "not", preceding the last three words thereof, so that as corrected the sentence will read, "When a corporation used money thus received in a reorganization for the purpose of directly discharging its bonded indebtedness, it was held that such use was not a statutory distribution." It is further

Ordered that the original of the official opinion be corrected by interlining the word "not" at the place hereinbefore designated.

Dated March 30, 1936.

(Seal of U. S. Board of Tax Appeals.) JOHN M. STERNHAGEN, Member.

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22 (Order of Redetermination, April 17, 1936.)

United States Board of Tax Appeals
Washington

Minnesota Tea Company, Petitioner,
Docket No. 54227. vs.
Commissioner of Internal Revenue, Respondent.

Subsequent to the Board's report, promulgated March 18, 1936, the respondent filed a proposed judgment, which the petitioner agrees is in accordance with the said report. It is, therefore,

Ordered, Adjudged and Decided that there is no deficiency in income tax for the period January 1, 1928, to August 24, 1928.

Enter

Entered April 17, 1936.

(Seal of U. S. Board of Tax Appeals.) JOHN M. STERNHAGEN, Member.

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23 (Petition of Guy T. Helvering, Commissioner of Internal Revenue, for Review of Decision of United States Board of Tax Appeals.)

(Filed July 3, 1936, United States Board of Tax Appeals.)

In the United States Circuit Court of Appeals for the Eighth Circuit.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner on Review.
No. 54227. vs. B. T. A.
Minnesota Tea Company, Respondent on Review.

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Now Comes Guy T. Helvering, Commissioner of Internal Revenue by his attorneys, Robert H. Jackson, Assistant Attorney General, Herman Oliphant, General Counsel for the Department of the Treasury and George D. Brabson, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

Your petitioner on review hereinafter referred to as the Commissioner, is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States.

Your respondent on review, hereinafter referred to as the taxpayer, is a corporation organized under the laws of the State of Minnesota with its principal office and place of business at Duluth, Minnesota, and filed its income tax return for the year in question with the Collector of Internal Revenue for the District of Minnesota, whose office is located in the City of St. Paul, Minnesota, and within the judicial circuit of the United States Circuit Court of Appeals for the Eighth Circuit.

II.

24 The Commissioner determined a deficiency of Federal income taxes against the taxpayer for the period January 1 to August 24, 1928, in the amount of $11,587.64, and on January 26, 1931, in accordance with the provisions of Section 272, Revenue Act of 1928, sent to the taxpayer by registered mail a notice of said deficiency. Thereafter, on March 21, 1931, the taxpayer filed an appeal from said notice of deficiency with the United States Board of Tax Appeals, being Docket No. 54227.

On June 30, 1933, the Board of Tax Appeals promulgated its opinion and on November 13, 1933, entered its final order and decision wherein and whereby the Board of Tax Appeals ordered and decided that the transaction in question did not constitute a statutory reorganization within the meaning of the Revenue Acts, and that the taxpayer was subject to tax upon the entire amount of the profit realized from the sale of its assets to Grand Union Company, and upon the basis of an amended answer filed by the Commissioner in order to conform said answer to the proof, found a deficiency in tax against the taxpayer in the amount of $72,686.90 for the period January 1, 1928, to August 24, 1928.

An appeal therefrom was taken by the taxpayer to this Honorable Court which under date of March 25, 1935, rendered its decision, reversing the Board of Tax Appeals upon the issue of the statutory reorganization and remanded the case to the Board of Tax Appeals for further proceedings in accordance therewith. The Commissioner thereupon petitioned for a writ of certiorari to the Supreme Court of the United States which petition was granted, and under date of December 16, 1935, the Supreme Court rendered its decision affirming the decision of this Honorable Court.

25

The case was thereupon remanded to the Board of Tax Appeals for further proceedings in accordance with the mandate.

A second hearing of the case was thereupon had before the Board of Tax Appeals which on March 18, 1936, promulgated its opinion and on April 17, 1936, entered its final order and decision wherein and whereby the Board of Tax Appeals ordered and decided that the deficiency determined by the Commissioner in his notice of deficiency was erroneous, and that there was no deficiency against the taxpayer for the period in question. The opinion of the Board of Tax Appeals is reported in 34 B. T. A.,—No. 21.

III.

The nature of the controversy is as follows:

Taxpayer is a Minnesota Corporation with its principal office and place of business at Duluth, Minnesota. Prior to August 24, 1928, taxpayer was engaged in the business of selling tea and coffee.

On July 14, 1928, in anticipation of the subsequent sale of its business taxpayer transferred to Peterson Investment Company, a new corporation organized for the purpose by the taxpayer, all its lands, buildings, investments, and certain other assets at book value, receiving in exchange therefor all of the outstanding shares of common stock of said investment company. Immediately thereafter the taxpayer distributed all said common stock to its shareholders pro rata.

26 On August 23, 1928, taxpayer sold its remaining business assets having a book value of $199,016.09, to the Grand Union Company, a Delaware Corporation, for which taxpayer received $426,842.52 in cash and 18,000 shares of common stock of Grand Union Company having a fair market value on that date of $33.00 per share.

Immediately after the foregoing sale was consummated taxpayer by corporate resolution voted to disburse the cash received on the sale to its stockholders upon the express undertaking of the stockholders to assume and pay all outstanding indebtedness of the taxpayer amounting to $106,471.73. The cash was disbursed and $106,471.73 was used by the stockholders to pay said indebtedness.

In the proceeding before the Board taxpayer contended that the $106,471.73 was a distribution of corporate earnings within the meaning of Section 112 (d) (1) and being pursuant to a plan of reorganization the gain to the corporation was not recognized.

The Commissioner contended before the Board that the $106,471.73 was disbursed to the stockholders for the specific purpose of paying the corporate debts, that the stockholders assumed its obligations and paid them, and that the $106,471.73 was charged with the payment of said debts and impressed with a trust for that purpose, and hence it could not constitute a distribution of earnings within the meaning of the statute.

The Board held that all of the cash disbursed by taxpayer to its stockholders constituted a statutory distribution regardless of the conditions imposed upon the $106,471.73 in question, and regardless of how said disbursement of cash was used by the stockholders.

IV.

27 The Commissioner says that in the record and proceedings before the Board of Tax Appeals and in the decision and final order of redetermination entered by the Board manifest error occurred and intervened to the prejudice of the Commissioner and the Commissioner hereby assigns the following errors which he avers occurred in said record, proceedings, decision and final order of redetermination so entered by the Board, to-wit:

1. The Board erred in holding that funds disbursed by a corporation to its stockholders for the purpose of paying corporate debts is a distribution of gain or profits.

2. The Board erred in holding that a disbursement of funds by a corporation to its stockholders for the purpose of paying corporate debts was not a disbursement for the benefit of such creditors.

3. The Board erred in holding that the sum of $106,471.73 received by the stockholders for the purpose of paying the corporate debts of the Minnesota Tea Company constituted a distribution to said stockholders within the meaning of Section 112 (d), Revenue Act of 1928.

4. The Board erred in failing to hold that such a disbursement was in effect impressed with a trust for the benefit of such creditors.

5. The Board erred in holding that the disbursement of said funds to the stockholders was not conditioned upon the agreement of the stockholders to pay the corporate debts.

6. The Board erred in failing to hold that the agreement of the stockholders to pay the corporate debts prevented the

disbursement of $106,471.73 from becoming a statutory distribution.

7. The Board erred in holding that the burden of proof was upon the respondent to show the nature of said disbursement.

8. The Board erred in failing to hold that the burden of proof was upon the petitioner to show the nature of said disbursement.

9. The Board erred in failing to hold for the respondent upon the facts stipulated in the case.

Wherefore, the Commissioner petitions that the decision and final order of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the First Circuit, that a transcript of the record be transmitted to the Clerk of said court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by the said court.

ROBERT H. JACKSON,
Assistant Attorney General.

HERMAN OLIPHANT,
General Counsel for the Department of the Treasury.

GEORGE D. BRABSON,
Special Attorney,
Bureau of Internal Revenue.

MFH
7/1/36

United States of America,
District of Columbia.—ss.:

George D. Brabson, being duly sworn, says that he is a special attorney in the office of the General Counsel for the Department of the Treasury, and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

GEORGE D. BRABSON.

Sworn and subscribed to before me this Second day of July, 1936.

My commission expires: Nov. 16, 1937.

GEORGE W. KREIS,
Notary Public.

GDB:MFH
7/1/36

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30 (Notice of Filing of Petition for Review and Service on Counsel for Respondent.)

(Filed July 6, 1936, United States Board of Tax Appeals.)

To:

Homer Hendricks, Esq.,
920 Southern Building,
Washington, D. C.

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of July, 1936, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 3rd day of July, 1936.

HERMAN OLIPHANT,
General Counsel for the
Department of the Treasury.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 6th day of July, 1936.

HOMER HENDRICKS,
Attorney for Respondent on Review.

MFH
7/1/36

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31 (Notice of Filing of Petition for Review and Service on Respondent.)

(Filed July 16, 1936, United States Board of Tax Appeals.)

To:

Minnesota Tea Company,
2023 West Superior Street,
Duluth, Minnesota.

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of July, 1936, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is attached hereto and served upon you.

Dated this 3rd day of July, 1936.

HERMAN OLIPHANT,
General Counsel for the
Department of the Treasury.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 7 day of July, 1936.

MINNESOTA TEA COMPANY,
By E. C. Peterson, Pres.
Respondent on Review.

MFH
6 7/3/36

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32 Agreed Statement of Fact.

(Filed at Hearing October 12, 1932, U. S. Board of Tax Appeals.)

United States Board of Tax Appeals.

Minnesota Tea Company, Petitioner,
Docket No. 54227. vs.
Commissioner of Internal Revenue, Respondent.

It is hereby stipulated and agreed by and between Minnesota Tea Company, petitioner, and the Commissioner of Internal Revenue, respondent, by their respective attorneys,

that the following facts shall be taken as true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not at variance with the facts herein stipulated.

1. The petitioner is a Minnesota corporation with principal office at 2023 West Superior Street, Duluth, Minnesota, engaged in the business of selling teas, coffees, and groceries at retail.

2. On July 14, 1928, the petitioner formed, or caused to be formed, the Peterson Investment Company, a corporation, and transferred thereto certain of its assets in exchange for the entire capital stock of Peterson Investment Company. The assets so transferred to the newly formed corporation consisted of real estate and buildings, investments and
33 other miscellaneous assets. Immediately upon receipt of the stock of Peterson Investment Company it was distributed by petitioner pro rata among its stockholders.

3. The organization of Peterson Investment Company, and the subsequent action described in paragraph 2 immediately preceding, was accomplished in accordance with a resolution of the stockholders of Minnesota Tea Company, adopted on June 18, 1928, a copy of which is attached hereto, made a part hereof, and marked Exhibit F.

4. On August 23, 1928, petitioner transferred all of its assets to Grand Union Company, another corporation, and received in exchange therefor 18,000 shares of common stock of said Grand Union Company, plus $426,842.52 in cash.

5. The transfer effected as described in paragraph 4, immediately preceding, was accomplished in accordance with the following plan:

(a) On August 22, 1928, the stockholders of Minnesota Tea Company adopted a resolution, a copy of which is attached hereto, made a part hereof, and marked Exhibit A.

(b) A copy of the option dated July 2, 1928, referred to in the aforedescribed resolution is attached hereto, made a part hereof, and marked Exhibit B.

(c) On August 22, 1928, the Directors of Minnesota Tea Company adopted a resolution, a copy of which is attached hereto, made a part hereof, and marked Exhibit C.

(d) On July 6, 1928, the option of July 2, 1928, was accepted by O. B. Westphal, Esq., who in all of the transactions

with Minnesota Tea Company was acting as agent for Grand Union Company.

34 (e) On July 24, 1928, an agreement supplemental to the option of July 2, 1928, was accomplished, a copy of which is attached hereto, made a part hereof, and marked Exhibit D.

(f) Also attached hereto and made a part hereof is a copy of the minutes of a stockholders meeting held on August 23, 1928, marked Exhibit E.

6. Upon receipt of such consideration, the petitioner immediately paid the entire sum of $426,842.52 so received, to its stockholders in proportion to their stockholdings.

7. Said payment was made pursuant to the following resolution adopted at a special meeting of the stockholders of petitioner held on August 22, 1928, at which the aforesaid reorganization was approved by the stockholders:

"Resolved further that all moneys received by Minnesota Tea Company on such sales of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corpo-
35 rate debts of the Minnesota Tea Company whether due and payable or not and whether certain or contingent."

8. The amount of the liabilities of the petitioner at August 23, 1928, which were assumed and discharged by the stockholders of petitioner, pursuant to the foregoing quoted resolution, was $106,471.73.

9. Respondent in determining the proposed deficiency herein added to petitioner's taxable income an amount of

$106,471.73, representing an alleged profit realized upon the above transfer of assets to Grand Union Company.

10. If the said amount of $106,471.73 so added by the Commissioner to petitioner's taxable income, be excluded therefrom, petitioner sustained a net loss for the year 1928.

C. J. McGUIRE,
Attorney for Petitioner.

C. M. CHAREST,
General Counsel,
Attorney for Respondent.

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36 Exhibit A.

Minutes of the special meeting of the stockholders of Minnesota Tea Company, held at its office in the City of Duluth, Minnesota, on the 22nd day of August, 1928, at ten o'clock in the forenoon.

Pursuant to the call of the president a special meeting of the stockholders of the company was held at its offices, in the City of Duluth, Minn., on August 22nd, 1928, at ten o'clock in the forenoon, after all the stockholders in writing had mutually agreed and consented to the holding of such meeting and waived notice of the time and place and the purposes of such meeting required by the by-laws of the company and the statutes of the state.

All the stockholders were present during the meeting and participated therein and in the proceedings.

E. C. Peterson presided and A. F. Peterson acted as the secretary thereof.

The president reported to the meeting that it was advisable that all the assets of the company should be sold under the option dated July 2, 1928, given by the president and secretary to O. B. Westphal as modified by an agreement dated July 24th, 1928, upon the terms therein set out, except that, as the company has conveyed all its real estate, the lease specified in such option shall be made by Peterson Investment Company, the owner of the property, and further that it was advisable to distribute to the company's stockholders all the moneys received on such sale, whenever received by the company, ratably according to their stockholdings, and that the stockholders should assume the corporate debts to enable it to hold all the corporate stock or securities received.

After a full discussion and consideration of the matters relating to such reorganization and in order to effect such reorganization by the sale of the company's assets for corporate securities or stock and moneys and the distribution of the moneys to the stockholders and the retention by the company of all the said stock and securities, a written resolution was read and its adoption moved, seconded and carried by the unanimous vote of all the stockholders. Such resolution was of words and tenor as follows:

"Resolved that the written option, dated July 2nd, 1928, and made by the President and Secretary of the company, in behalf of Minnesota Tea Company, to O. B. Westphal, signed by said officers and said O. B. Westphal, and the written agreement, dated July 24th, 1928, and made by said officers of the company and said O. B. Westphal, modifying the said option, be and hereby are ratified, confirmed and approved, and that the actions of the President and Secretary in giving and executing such option and in signing and executing such agreement modifying said option be and are hereby in all things ratified, confirmed and approved.

Resolved further that the assets of Minnesota Tea Company described in said option, being all, or substantially all, the assets of Minnesota Tea Company, be sold and delivered to said O. B. Westphal, or his nominee, in pursuance of and under such option and agreement modifying the same and on the terms therein stipulated and thereby agreed and for the consideration therein and thereby stipulated, or upon such other terms as may be deemed advisable by the board of directors, and that any other assets, if any there be, owned by, or in the disposition of, Minnesota Tea Company be sold or assigned by this company to the purchaser of the assets specified in said option, if possible, upon such terms as may be obtained.

37 Resolved further that the Board of Directors be and hereby are authorized and directed to effect and make such sale and transfer of all the assets of Minnesota Tea Company upon the terms and for the considerations stipulated in said option and agreement modifying the same, or upon such other terms as the Board of Directors, or the president, by the board thereto authorized, may deem advisable.

Resolved further that the Board of Directors, in order to effect such sale of said assets of this company, and to carry out the terms of said option as modified and of the terms of any agreement, hereby authorized, relative thereto, be and are hereby authorized and directed to cause to be executed

and delivered to the purchaser of said assets, in behalf of and by Minnesota Tea Company, any bill of sale, assignments, agreements or other instruments by the President and the Secretary and to cause Peterson Investment Company to execute the lease specified in said option to The Grand Union Company on terms satisfactory to The Grand Union Company.

Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock and securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of Minnesota Tea Company whether due and payable or not and whether certain or contingent.

Resolved further that Minnesota Tea Company shall continue to own and hold the said corporate stock and securities without the sale or distribution thereof."

It was then moved, seconded and carried by the vote of the stockholders that the written consent to the holding of the special meeting and the waiver of notice of the holding thereof and the written resolution adopted at the meeting be copied into the minutes of the meeting and that said written consent and waiver and said written resolution adopted be filed with the files and records of the company.

The said written consent and waiver were of the following words and tenor:

We, the undersigned, being all the stockholders of Minnesota Tea Company, do hereby mutually consent to the holding of a special meeting of the stockholders of Minnesota Tea Company and its stockholders at the office of the corporation, in the City of Duluth, Minnesota, for any purpose, or

purposes, that may affect the corporation and its business, as called by the President, and we waive any and every notice, or notices, of such meeting and of the purpose thereof required by the statutes of Minnesota or the By-Laws of the corporation.

Dated August 22, 1928.

E. C. PETERSON,
L. T. PETERSON,
A. F. PETERSON.

38 The meeting of the stockholders adjourned on motion made and carried.

A. F. PETERSON,
Secretary,

Attest:

E. C. PETERSON,
President.

The undersigned, being all the stockholders of Minnesota Tea Company do hereby certify that the foregoing minutes are true and correct.

E. C. PETERSON,
L. T. PETERSON,
A. F. PETERSON.

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39 (Praecipe for Transcript.)

(Filed August 31, 1936, United States Board of Tax Appeals.)

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Eighth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.

2. Pleadings before the Board, including:

(a) Petition, including annexed copy of deficiency letter:

(b) Answer.

3. Opinion of the Board promulgated March 18, 1936, and decision of the Board entered April 17, 1936.

4. Petition for review, together with proof of service of notice of filing petition for review, and of service of a copy of petition for review.

5. Stipulation of facts filed August 12, 1932, at the original hearing of the case, and Exhibit A, filed at said hearing (resolution of stockholders).

6. Orders enlarging time for preparation of the evidence and for the transmission and delivery of the record.

40 7. This praecipe.

HERMAN OLIPHANT,
General Counsel for the
Department of the Treasury.

Service of a copy of the within praecipe is hereby admitted this 26th day of Sept., 1936.

JAMES G. NYE,
Attorney for Respondent.

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41 (Clerk's Certificate to Transcript.)

United States Board of Tax Appeals
Washington

Commissioner of Internal Revenue, Petitioner,
Docket No. 54227. vs.
Minnesota Tea Company, Respondent.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 40, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal as above numbered and entitled.

Seal
U. S. Board of
Tax Appeals
1924

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 23d day of September, 1936.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

Filed Sep. 26, 1936. E. E. Koch, Clerk.

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34 And thereafter the following proceedings were had in said cause in the Circuit Court of Appeals, viz.:

(Appearance of Mr. Herman Oliphant as Counsel for Petitioner.)

United States Circuit Court of Appeals
Eighth Circuit.

Guy T. Helvering, Commissioner, etc., Petitioner,
No. 10,763. vs.
Minnesota Tea Company.

The Clerk will enter my appearance as Counsel for the Petitioner.

HERMAN OLIPHANT,
General Counsel for the Department of the Treasury,
Washington, D. C.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Oct. 3, 1936.

(Appearance of Mr. George D. Brabson as Counsel for Petitioner.)

The Clerk will enter my appearance as Counsel for the Petitioner.

GEORGE D. BRABSON,
Special Attorney, Bureau of Internal Revenue,
Washington, D. C.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Oct. 3, 1936.

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35 (Appearance of Mr. Robert H. Jackson and Mr. Sewall Key as Counsel for Petitioner.)

The Clerk will enter my appearance as Counsel for the Petitioner.

ROBERT H. JACKSON,
Assistant Attorney General.

SEWALL KEY,
Special Assistant to the Attorney General.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Oct. 5, 1936.

(Appearance of Mr. James W. Morris and Mr. Maurice J. Mahoney as Counsel for Petitioner.)

The Clerk will enter our appearances as Counsel for the Commissioner.

JAMES W. MORRIS,
Assistant Attorney General.

SEWALL KEY,
MAURICE J. MAHONEY,
Special Assistants to the Attorney General.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Jan. 25, 1937.

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36 (Appearance of Counsel for Respondent.)

The Clerk will enter my appearance as Counsel for the Respondent.

OSCAR MITCHELL,
JAMES S. NYE,
1200 Alworth Bldg., Duluth, Minn.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Oct. 7, 1936.

(Order of Submission.)

March Term, 1937.

This cause having been called for hearing in its regular order, argument was commenced by Mr. Maurice J. Mahoney, Special Assistant to the Attorney General, for petitioner, continued by Mr. James G. Nye for respondent, and concluded by Mr. Maurice J. Mahoney, Special Assistant to the Attorney General, for petitioner.

Thereupon, this cause was submitted to the Court on the transcript of the record from said Board of Tax Appeals and the briefs of counsel filed herein.

United States Circuit Court of Appeals
Eighth Circuit.

No. 10,763.—MARCH TERM, A. D. 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
vs.
Minnesota Tea Company, Respondent.

On Petition to Review Decision of United States Board of Tax Appeals.

[April 7, 1937.]

Mr. Maurice J. Mahoney, Special Assistant to the Attorney General (Mr. Robert H. Jackson, Assistant Attorney General, and Mr. Sewall Key, Special Assistant to the Attorney General, were with him on the brief) for petitioner.

Mr. James G. Nye (Mr. Oscar Mitchell and Messrs. Mitchell, Gillette, Nye & Harries were with him on the brief) for respondent.

Before STONE, GARDNER and WOODROUGH, Circuit Judges.

STONE, Circuit Judge, delivered the opinion of the court.

This is a petition for review of an order of the Board of Tax Appeals denying a redetermination of income tax for 1928 assessed against respondent by the Commissioner of Internal Revenue.

For years prior to 1928, respondent corporation had been engaged in retail business. On June 18, 1928, the stockholders of respondent (three in number) resolved to form a corporation to be known as the Peterson Investment Company. July 2nd, respondent gave an option on certain assets to the Grand Union Company. July 6th, this option was accepted. July 14th, the Peterson Investment Company was organized and its entire

stock acquired by respondent in exchange for the real estate, buildings, investments and some miscellaneous assets of respondent—the property so exchanged included all owned by respondent except the assets covered by the option. Such stock was immediately distributed to the three stockholders of respondent. July 24th, there was a supplemental agreement to the option between respondent and the Grand Union Company. August 22nd, a stockholders' meeting of respondent adopted a resolution whereby it was provided that all moneys received under the contracts with the Grand Union Company should be at once distributed to the three stockholders "in the proportion of their respective stockholdings" in respondent "upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock [in the Grand Union Company] or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same."(1) August 23rd, the contracts were performed by the transfer of all these assets of respondent to the Grand Union Company in return for 18,000 shares of common stock of that company and $426,842.52 in cash. Immediately, this cash was distributed to the three stockholders in proportion to their respective holdings in respondent and the stockholders assumed payment of like proportionate parts of the corporate indebtedness of respondent, amounting to $106,471.73. This assumed indebtedness has been paid by the stockholders.

Both the Commissioner and the taxpayer assumed this entire transaction to be a reorganization within Section 112 of the Revenue Act of 1928 (45 Stat. 791). Though so assuming, the Commissioner assessed a tax against $106,471.73, which was the indebtedness of respondent assumed and paid by its stockholders as above. Upon appeal by respondent to the Board of Tax Appeals, the Board, of its own volition, examined and determined that the transaction was not a reorganization within Section 112 but was

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(1) The resolution is as follows:

"Resolved further that all moneys received by Minnesota Tea Company on such sales of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stock holdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company whether due and payable or not and whether certain or contingent."

a sale of assets by respondent to the Grand Union Company. On petition to review, this Court held the transaction was within Section 112 and remanded the matter to the Board for further proceedings (76 Fed. [2d] 797). The Supreme Court granted certiorari (296 U. S. 562) and affirmed the decision of this Court (296 U. S. 378).

On retrial, the Board determined there was no tax liability as to the $106,471.73, representing the above indebtedness. The Commissioner brings this petition for review to question that ruling.

The issue is well and concisely stated in the opinion of the Board as follows:

"The petitioner [taxpayer] contends that immediately upon the receipt of the Grand Union shares and the $426,842.52, it distributed the money in pursuance of the plan of reorganization, and that the situation is squarely within section 112(d)(1), Revenue Act of 1928, providing that 'no gain shall be recognized.' The respondent urges that the shareholders' assumption of the corporate debts prevents the amount of $106,471.73 from being regarded as a distribution by the corporation, and hence that it may not escape recognition as part of the corporation's gain."

The plan of reorganization is an exhibit introduced in evidence before the Board but not included in the record here. In view of the decision of the Supreme Court in this case and the tacit agreement of the parties that this payment to the stockholders was "in pursuance of the plan of reorganization", as required by Section 112(d), we assume this to be true and further consideration of the issue before us is based thereon. Without such assumption, we should have to have before us the "plan" and to determine whether this payment was *in pursuance* thereof.

The determination of the issue before us depends upon certain legal principles in conjunction with the construction of the Act here involved. Those principles are as follows. It is an exemption from taxation which is here claimed by respondent and upon it lies the burden of establishing the right thereto (*Gregory* v. *Helvering*, 293 U. S. 465, 469; *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440; *Bowers* v. *Lawyers Mortg. Co.*, 285 U. S. 182, 187); for income tax purposes, the component parts of a single transaction cannot be treated separately (*Bassick* v. *Commissioner*, 85 Fed. (2d) 8, 10, C. C. A. 2, certiorari denied 299 U. S. .....; *Ahles Realty Corp.* v. *Commissioner*, 71 Fed. (2d) 150, 151, C. C.

A. 2, certiorari denied 293 U. S. 611; *Prairie Oil & Gas Co.* v. *Motter,* 66 Fed. [2d] 309, 311, C. C. A. 10); payment of a debt is income to the debtor for taxation purposes *(Helvering* v. *Midland Mutual Life Ins. Co.,* ..... U. S. ..... [Feb. 15, 1937]; *Raybestos-Manhattan Co.* v. *United States,* 296 U. S. 60, 64; *Douglas* v. *Willcuts* 296 U. S. 1, 8; *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716, 729; *United States* v. *Boston & Maine Railroad,* 279 U. S. 732, and applying this rule in reorganization matters and exchanges see *West Texas R. & D. Co.* v. *Commissioner,* 68 Fed. [2d] 77, 80, C. C. A. 10 and *The Liquidating Co.* v. *Commissioner,* 33 B. T. A. 1173, 1184); distribution within the reorganization provisions of the Revenue Acts means distribution to stockholders and not payment of corporate debts *(West Texas R. & D. Co.* v. *Commissioner,* 68 Fed. [2d] 77, 80, C. C. A. 10).

The reorganization provisions (Section 112[a] and [d]) of the Revenue Act of 1928 reveal (as pertinent here) the following: First, that the provisions that no gain or loss is recognized from certain exchanges do not grant an exemption and are not so intended but operate only as a postponement of the tax until gain is clearly realized by a future sale or exchange amounting thereto; Second, that where money and/or property, other than stock or securities in the new reorganized company or in a participating corporation, are received a gain from the exchange is recognized as realized but not in excess of such money and property; Third, that the provisions as to distribution to stockholders of such money and/or property had as a main purpose to prevent tax evasions through distribution as capital gains what was in effect dividends out of earnings—thus avoiding higher surtax rates. These three conclusions as to the construction of the statute are based on the wording of the Act and the clarifying Congressional Reports.(2)

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(2) The provisions of the Act of 1928 here pertinent are essentially the same as in the Act of 1924 (June 2, 1924, 43 Stat. 253) though the section numbers differ. The Committee Reports upon the Act of 1924 are revealing and pertinent. The reorganization provisions in that Act are mostly in Section 203 with related matters in Sections 201(c)(d) and 204(a)(6)-(9). Extracts from these reports are as follows:

"CHANGES DESIGNED TO PREVENT THE AVOIDANCE OF THE INCOME TAX.

Consistent with the principle of imposing an income tax which can be collected, a tax which is an actuality and not a pretense, the committee recommends certain amendments to the income tax law to stop the methods of avoidance which are now being commonly availed of by taxpayers.

* * * * * * *

(2) The provisions of the reorganization section have been rewritten to prevent the use of the section to escape proper taxation by increasing the basis for depreciation or depletion or by increasing the basis for determining gain or loss from the sale of assets transferred in connection with a reorganization or by distributing as capital gains what are in effect dividends out of earnings." (H. R. No. 179, pp. 6 and 7 and 44; S. R. #398, p. 7).

"Section 203(d):

(1) Paragraph (1) of Subdivision (d) corresponds to section 202 (e) of the existing law as amended by the act of March 4, 1923, and provides that where

Applying the above principles of law and the three above conclusions to the situation here, there results the following: (a) respondent received, along with 18,000 shares of stock in the Grand Union Company, $426,842.52 in cash; (b) this cash, if undistributed by respondent to its stockholders, would have constituted a realization upon the exchange to that amount and, therefore, would be subject to taxation against it as gain in so far as it constituted a capital gain; (c) if this entire amount be distributed absolutely to the stockholders, they and not it would be subject to such realization and to taxation thereon, under the applicable provisions of the Act, as upon individual incomes; (d) respondent received an advantage from the acquisition of this money from the Grand Union in that it secured the payment of its indebtedness in the sum of $106,471.73; (e) the payment of this indebtedness by the stockholders was a condition attached to and

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'boot' is given in connection with an exchange which would otherwise be tax free, the gain from the exchange shall be recognized, but in an amount not in excess of the amount of the money or other 'boot'.

(2) There is no provision of the existing law which corresponds to paragraph (2) of subdivision (d). This subdivision provides that any amount distributed by a corporation in connection with a reorganization which has the effect of a taxable dividend shall be taxed as a dividend and not as a taxable gain.

The necessity for this provision may best be shown by an example: Corporation A has capital stock of $100,000, and earnings and profits accumulated since March 1, 1913, of $50,000. If it distributes the $50,000 as a dividend to its stockholders, the amount distributed will be taxed at the full surtax rates.

On the other hand, corporation A may organize corporation B, to which it transfers all its assets, the consideration for the transfer being the issuance by B of all its stock and $50,000 in cash to the stockholders of corporation A in exchange for their stock in corporation A. Under the existing law, the $50,000 distributed with the stock of corporation B would be taxed, not as a dividend, but as a capital gain, subject only to the 12½ per cent rate. The effect of such a distribution is obviously the same as if the corporation had declared out as a dividend its $50,000 earnings and profits. If dividends are to be subject to the full surtax rates, then such an amount so distributed should also be subject to the surtax rates and not to the 12½ per cent rate on capital gain. Here again this provision prevents evasions.

Section 203(e):

There is no provision of the existing law which corresponds to subdivision (e) of the bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization transfers its assets to another corporation, a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss to the transferor is recognized, if it distributes the cash to its stockholders. But if the selling corporation fails to distribute the cash to its stockholders then the gain or loss is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is to be recognized, but if it retains all or any of the proceeds with the result that the transaction is in substance a real sale, then all or a part of the gain shall be recognized." (H. R. #179, pp. 14 and 52; S. R. #398, p. 15).

"BASIS FOR DETERMINING GAIN OR LOSS.

Section 204:

(1) There is no provision in the existing law which corresponds to paragraph (3). This paragraph applies the same principles to transfers to a trustee as is applied in paragraph (2) to gifts, and provides that where property was acquired after December 31, 1920, by a transfer in trust, the basis for determining the gain or loss from its sale shall be the same as it would be in the hands of the grantor.

(2) Paragraph (6) corresponds to section 202(d)(1) of the existing law. The general theory of this section is that where no gain or loss is recognized as resulting from an exchange, the new property received shall, for purposes of determining gain or loss from a subsequent sale and for depreciation and depletion, be considered as taking the place of the old property given up in

governing the distribution(3); (f) such payment was thus assumed and was made; (g) such payment reduced, by $106,471.73, the amount realized by the stockholders for their own benefit on the distribution; (h) respondent received the full benefit of this payment to the same extent as though it had retained that amount from distribution and applied it to payment of such indebtedness; (i) this sum cannot be regarded as gain to the stockholders and they could not be taxed individually therefor; (j) this was not a genuine distribution of this sum but a circuitous retention and application thereof by the respondent; (k) it is taxable to the respondent.

"Where the legal effect of a transaction fits the plain letter of the statute, the tax is held payable, unless there is clearly revealed in the Act itself or in its history a definite intention to exclude such transactions from the operation of its applicable language" (*Helvering* v. *Midland Mutual Life Ins. Co.*, ... U. S. ..... [Feb. 15, 1937]) and (from the same opinion) "There is nothing unfamiliar in taxing on the basis of the legal effect of a transaction."

The result is that the determination of the Board must be reversed and the cause remanded to the Board with instructions to set aside the order here under review and to proceed to ascertain the amount, if any, of gain by respondent from the transaction with the Grand Union and of the tax due (up to $106,471.73) upon such gain.

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connection with the exchange. The provisions of section 203 of the bill that no gain or loss is recognized from certain exchanges do not grant an exemption and are not so intended. These provisions are based upon the theory that the types of exchanges specified in section 203 are merely changes in form and not in substance, and consequently should not be considered as affecting a realization of income at the time of the exchange. In other words, these provisions result not in an exemption from tax but in a postponement of tax until the gain is realized by a pure sale or by such an exchange as amounts to a pure sale. It follows, therefore, that in the case of such an exchange the property received should be considered as taking the place of the property exchanged. If in connection with the exchange money is received which is not taxed, obviously the basis at which the old property is carried on the books of the taxpayer should be reduced to that extent, since the taxpayer has in part received a return of capital. But if money is received in connection with the exchange and the money is taxed, it is equally obvious that the basis of the old property should not be affected." (H. R. #179, pp. 16 and 54; S. R. 398, p. 17).

(3) The resolution authorizing the distribution provided that this money should be distributed ratably to the stockholders "upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company" and the Board of Directors of respondent were "hereby authorized and directed to so distribute the said moneys as aforesaid" and to enter into a written agreement with the stockholders "whereby said stockholders, in consideration of such distribution * * * to pay all the corporate debts of the Minnesota Tea Company * * *."

44 (Decree.)

United States Circuit Court of Appeals
Eighth Circuit.

March Term, 1937.

Thursday, April 8, 1937.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,
No. 10,763. vs.
Minnesota Tea Company.

On Petition to Review Decision of United States Board of Tax Appeals.

This cause came on to be heard on the petition for review of an order of the United States Board of Tax Appeals denying a redetermination of income tax for 1928 assessed against the respondent, and was argued by counsel.

On Consideration Whereof, It is now here ordered, adjudged and decreed by this Court that the order of the said Board of Tax Appeals in this cause, be, and the same is hereby, reversed, without the taxation of costs in favor of either of the parties in this Court.

And it is further ordered by this Court that this cause, be, and the same is hereby, remanded to the said Board of Tax Appeals to set aside the order here under review and to proceed to ascertain the amount, if any, of gain by respondent from the transaction with the Grand Union Company and of the tax due (up to $106,471.73) upon such gain.

April 8th, 1937.

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45 (Clerk's Certificate.)

United States Circuit Court of Appeals,
Eighth Circuit.

I, E. E. Koch, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing contains the record on petition to review the decision of the United States Board of Tax Appeals as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its Clerk, and full, true and complete copies of all the pleadings, record entries and proceedings, including the opinion, had and filed in the United States Circuit Court of Appeals, except the full captions, titles and endorsements omitted in pursuance of the rules of the Supreme Court of

the United States, in a certain cause in said Circuit Court of Appeals wherein Guy T. Helvering, Commissioner of Internal Revenue, was Petitioner, and the Minnesota Tea Company was Respondent, No. 10,763, as full, true and complete as the originals of the same remain on file and of record in my office.

I do further certify that on the twenty-eighth day of April, A. D. 1937, a mandate was issued out of said Circuit Court of Appeals in said cause, directed to the United States Board of Tax Appeals.

In Testimony Whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit, at office in the City of St. Louis, Missouri, this seventeenth day of May, A. D. 1937.

E. E. KOCH,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

(Seal)

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 11, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Black took no part in the consideration and decision of this application.

FILE COPY

Office - Supreme Court, U. S.
FILED
JUN 2 1937
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

JAMES G. NYE,
Counsel for Petitioner.

GILLETTE, NYE, HARRIES & MONTAGUE,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Minnesota Tea Company, petitioner above named, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit, entered in the above entitled cause on April 7, 1937.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 13 ff.) is reported in 34 B. T. A. 145.

The opinion of the Circuit Court of Appeals is not yet officially published, but may be found in 374 C. C. H., page 9780 ¶9228, (R. 36 ff.).

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 7, 1937. The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Whether the fact that stockholders assume and pay certain indebtedness of a corporation pursuant to a statutory reorganization, renders the corporation subject to tax on a gain which otherwise would not be recognizable to it under the provisions of Sec. 112(d) of the Revenue Act of 1928.

Statutes and Regulations Involved.

The pertinent statutes and regulations involved will be found in the Appendix.

Statement.

On August 23, 1928, pursuant to a plan of statutory reorganization (see *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Minnesota Tea Co.* v. *Commissioner*, 76 F. (2d) 797), Minnesota Tea Company transferred all its property to the Grand Union Company, in exchange for 18,000 shares of the common stock (voting trust certificates) of the latter company, plus $426,842.52 in cash. Pursuant to the plan of reorganization, Minnesota Tea Company thereupon distributed all the cash to its stockholders, who assumed and agreed to pay, and later actually paid, liabilities of the petitioner to the extent of $106,471.73.

The resolution of the stockholders of the petitioner under which the cash was distributed is as follows:

> "Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be im-

mediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholders in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of Minnesota Tea Company whether due and payable or not and whether certain or contingent'' (R. 28).

In his notice of deficiency (R. 7-12) the Commissioner of Internal Revenue proposed a deficiency of $11,587.64, on the theory that to the extent that liabilities of the petitioner had been assumed by the stockholders, the petitioner had not made distribution of the cash within the meaning of Section 112(d) of the Revenue Act of 1928, and that taxable gain of $106,471.73, the amount of said liabilities, was therefore recognizable and taxable to the petitioner.

The matter was thereupon brought before the Board of Tax Appeals for Review, upon the sole issue of whether or not the petitioner realized a taxable gain of $106,471.73 as a result of the transactions above set forth. No contention was made by the Government that the petitioner was taxable upon any greater sum than that amount. The Board of Tax Appeals, however, of its own motion, raised the question as to whether such statutory reorganization

had been effected; and, in its decision, held that there was no reorganization, but a sale of assets, and that petitioner was taxable on the gain thereof. The case was then reviewed by the United States Circuit Court of Appeals for the Eighth Circuit, which (76 F. (2d) 797) reversed the Board of Tax Appeals in its conclusion on the reorganization question, and remanded the case to the Board of Tax Appeals for determination of the original issue. This Court granted certiorari (296 U. S. 562) on application of the Commissioner of Internal Revenue, and later affirmed the Circuit Court (296 U. S. 378). Upon affirmance by this Court, the Board of Tax Appeals, after a hearing pursuant to the mandate, in an opinion promulgated March 18, 1936, reported in 34 B. T. A. 145, held that the sum of $426,842.52 having been entirely distributed to the shareholders pursuant to the plan of reorganization, and in conformity to the reorganization provisions of the Revenue Act of 1928, no part thereof may be regarded as recognizable gain to the corporation, notwithstanding the assumption by the shareholders of the corporate debts.

Upon petition of the Commissioner of Internal Revenue, the Circuit Court of Appeals reviewed this second decision of the Board of Tax Appeals and, reversing the Board, held (R. 36 ff.) that notwithstanding literal compliance with the statute, the payment of the corporate debts by the stockholders under the circumstances here presented resulted in taxable gain to the corporation, up to $106,471.73, the amount of said debts.

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1) In holding that it is an exemption from taxation which is claimed by petitioner, and that upon it lies the burden of establishing the right thereto.

2) In failing to hold that it is the Government which claims an exemption from the operation of the statute, and upon it lies the burden of establishing such claim.

3) In holding that payment of the entire amount of cash received by Minnesota Tea Company from Grand Union Company to its stockholders in proportion to their stockholdings was not a distribution within Sec. 112(d)(1) of the Revenue Act of 1928.

4) In failing to hold that the transaction here involved constituted a compliance with Sec. 112(d) and hence that no gain should be recognized to the corporation.

5) In holding that the petitioner did not comply with Sec. 112(d) of the Revenue Act of 1928.

6) In holding that there was taxable gain to the petitioner by reason of the fact that its stockholders assumed and paid its liabilities.

7) In reversing the decision of the Board of Tax Appeals.

Reasons for Granting the Writ.

1) That the Circuit Court of Appeals for the Eighth Circuit has decided an important question of Federal law which has not been, but should be, settled by this Court.

2) That the Circuit Court of Appeals for the Eighth Circuit has decided a Federal question in a way probably in conflict with the applicable decisions of this Court.

The decision of the Circuit Court of Appeals for the Eighth Circuit in this case, if not reversed, will create confusion and uncertainty in the application of the reorganization provisions of the Federal income tax laws, in that the taxpayer can never be certain whether, notwithstanding compliance with the statute, he may be held to have ren-

dered himself liable to tax by selecting the wrong method of compliance.

In corporate mergers and reorganizations, the assumption of liabilities and the payment of debts is a very usual feature. The principal purpose and object of the negotiations leading up to a plan of reorganization is to reach an agreement or establish a basis as to the price to be paid for the *net* value of the stock or property to be transferred. When this has been done, it is largely a matter of legal detail and selection of mechanics as to the method by which the debts are paid. The more frequent ways in which this is done are:

1) The transferee may pay the transferor only the net worth of the assets and assume the liabilities (as was done in some of the cases hereinafter cited);

2) The transferor, before the actual transfer, may pay its own debts;

3) The transferee may pay the transferor the gross value of its assets but require the liabilities to be paid by it later from the cash received from the transferee; or,

4) The transferor may require its stockholders to pay the corporate debts (as in this case).

The financial result to the transferor is exactly the same in all four cases. It should, therefore, be made clear by this Court which, if any, of these methods of paying the transferor's debts would defeat compliance with Sec. 112 (d)(1) and render the corporation liable to tax upon the amount of said debts, notwithstanding there may have been a statutory reorganization.

It is believed by the petitioner that the question here involved is of such general importance in the application of the reorganization provisions of the Federal income tax

laws as to bring it clearly within the purview of Rule 38 (5)(b) of the Rules of this Court.

Moreover, there is considerable confusion in the decisions of the lower courts concerning the point here involved and points akin thereto. For example: The Board of Tax Appeals, in *Fashion Center Bldg. Co.*, 31 B. T. A. 167, held that the assumption of indebtedness is not "other property" within the meaning of Sec. 203(d)(1), 1926 Act, corresponding to Sec. 112(d)(1) of the 1920 Act. (See discussion, *infra.*)

The District Court of the United States for the District of Maryland, in *Hendler* v. *United States*, 17 Fed. Supp. 558 (decided December 30, 1936), held that money received by the transferor corporation and applied in pursuance of a plan of reorganization to the payment of debts is not to be treated as a taxable gain to the corporation.

There are numerous decisions where the transferee corporation has assumed liabilities of the transferor and where reorganizations involving this feature were held to be nontaxable without discussion of the point:

See *Coleman* v. *Commissioner*, 81 F. (2d) 455, 46; *G. & K. Mfg. Co.* v. *Commissioner*, 76 F. (2d) 454 (C. C. A. 4); reversed 296 U. S. 389, and remanded to the Board of Tax Appeals; *Starr* v. *Commissioner*, 82 F. (2d) 964 (C. C. A. 4); certiorari denied, 298 U. S. 680; *Watts* v. *Commissioner*, 76 F. (2d) 981 (C. C. A. 2), affirmed 296 U. S. 387; *Tulsa Oxygen Co.* v. *Commissioner*, 18 B. T. A. 1283; *Frank Keel*, 31 B. T. A. 212; *National Pipe & Foundry Co.* v. *Commissioner*, 19 B. T. A. 242; also see Barr & Morris, "Hidden Taxes in Corporate Reorganizations," p. 261, for a discussion of the point here involved.

The ultimate financial effect upon the corporation in the cases last cited (where the transferee corporation assumed the indebtedness) is precisely the same as in the present

case (where the stockholders assumed it). Yet, if the decision of the court below is not reversed, the tax result will be entirely different. Thus taxability is made to depend entirely on the machinery selected, rather than upon what was actually done—a result which is not only not in harmony with the avowed purpose of the Act, but which wholly disregards the plain wording of the statute.

As appears in "Statement of Changes in the Revenue Act of 1921 by the Treasury Department and the Reasons Therefor" prepared for the use of the Ways and Means Committee by A. W. Gregg, Special Assistant to the Secretary of the Treasury (see Appendix), Sec. 112(d) was included in the law in order that the tax results in the case of acquisition of *stock* of a transferor corporation and in the case of acquisition of *properties* of the transferor corporation should be the same, where there is a statutory reorganization.

To reach this sensible result, it was provided that where the corporation was a mere conduit, as here, for passing the proceeds of the sale to the ultimate owner, no recognizable gain should be deemed to accrue to the corporation. Nothing is said or implied in the statute, to the effect that an assumption of corporate debts by stockholders would nullify such procedure.

If the decision of the Circuit Court of Appeals is correct, the tax result can not be the same in cases of stock acquisition as in cases of property acquisition. If the results are not the same in the two types of reorganization, the intention of Congress is not given effect.

If the Grand Union Company had assumed and paid the liabilities of the petitioner and had given the latter only $320,370.79 instead of $426,842.52, the result to the petitioner would be exactly the same as it finally was. But, as above stated, the Board of Tax Appeals, in *Fashion Center*

Bldg. Co., 31 B. T. A. 167, has held that the assumption or payment of liabilities by the transferee corporation is not "other property or money" within the meaning of Sec. 112(d), and accordingly the petitioner would not, in such case, be liable for a tax on the amount of the indebtedness assumed. In other words, the Board of Tax Appeals, in that case refused to view the matter as though the transferor had constructively received the amount of the debts which it did not distribute. This appears to be in accord with the holding in *Coleman* v. *Commissioner*, 81 F. (2d) 455, 456, and other cases hereinbefore cited. However, the Board later indicated, in *Brons Hotels, Inc.* v. *Commissioner*, 34 B. T. A. 376, that it would not follow *Fashion Center Bldg. Co.*, (*supra*) at least in case of exchanges of real estate where mortgage indebtedness is assumed.

Moreover, if the view that assumption of indebtedness is the equivalent of cash, should ever prevail, then the acquisition by one corporation of substantially all the properties of another in return for voting stock plus the assumption of liabilities of the transferring corporation, would not be a reorganization within the statutory definition, as the acquiring corporation would not give "solely" its voting stock in return for the assets. Any such result, we submit, would be unsound and out of harmony with the purpose of the reorganization provisions.

So here, where the result to the transferring corporation was precisely the same as in the example last above cited, consistency demands a similar tax result.

It was natural and proper for the parties to handle the transaction here involved in a manner that would reduce taxes. The statute clearly provided a way to do this. The effect of the decision of the Circuit Court is to disregard what was actually done; to disregard compliance with the

statute and (to use the language of the Board of Tax Appeals in its opinion herein) to convert an "actual distribution *pro tanto* into a constructive nondistribution."

As appears from the legislative history and from the decisions of this Court, the central thought of the reorganization provisions was to remove from ordinary business transactions the deterrent influence of immediate and possibly onerous taxation on merely paper profits, and to make sure that certain business adjustments involving exchanges in kind should not be hindered by the heavy tax burden. The taxation to a corporation of money received by it and distributed to its stockholders (even though they may agree to pay the corporate debts) pursuant to a plan of reorganization, would tend to nullify this intent of the statute. It is not a sufficient answer to say that in such case the tax must be imposed, otherwise a gain will escape taxation. The net gain to the corporation is not evidenced by money used to pay corporate debts, but by what it *retains* or *fails to distribute* to its stockholders; and when the money is distributed, they become ultimately liable to proper taxation on gain actually realized. The intent of the statute, therefore, was to postpone rather than to exempt from taxation.

It is said in the opinion below (R. 38): "It is an exemption from taxation which is here claimed by respondent (petitioner here) and upon it lies the burden of establishing the right thereto." We submit that this view of the matter is not sound, for the reason that it is admitted by the Government, in effect, that the petitioner here has complied literally with the statute. It is, therefore, not the petitioner who seeks exemption from taxation. It is the Government which seeks to nullify compliance with the statute and to claim exemption from its operation. The burden, therefore, is not upon the taxpayer to establish its right to exemption,

but upon the Government to establish its right to collect a tax upon the item in question.

WHEREFORE it is respectfully submitted that this petition should be granted.

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APPENDIX.

Statutes Involved.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. *Determination of Amount of Gain or Loss.*

* * * * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * * * *

SEC. 112. *Recognition of Gain or Loss.*

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * * * *

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization."

* * * * * * *

(d) *Same—Gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without

the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but—

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

Article 575 of Reg. 74 (1928 Act) provides in part:

* * * If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to the reorganization, for stock or securities in another corporation, a party to the reorganization and other property or money, then, if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation

will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case, no loss from the exchange will be recognized. (See Sec. 112(e).)

The provision in question first appeared ~~in~~ the Revenue Act of 1924, as to which the Ways and Means Committee (Rep. M. 179, 68 Cong. 1st Sess., p. 15) reported as follows:

> "There is no provision of the existing law which corresponds to subdivision (d) of the Bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization transfers its assets to another corporation a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss (sic) to the transferor is recognized, if it distributes the cash to its stockholders. But if the selling corporation fails to distribute the cash to its stockholders, then the gain or loss (sic) is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is to be recognized, but if it retains all or any part of the proceeds with the result that the transaction is in substance a real sale, then all or part of the gain shall be recognized."

The provision was further explained in "Statement of the Changes in the Revenue Act of 1921 by the Treasury Department, and the Reasons Therefor," prepared for the use of the Ways and Means Committee, by A. W. Gregg, Special Assistant to the Secretary of the Treasury, printed in full in the New York Times for January 5, 1924:

> "A corporation in connection with a reorganization may make distribution of its assets in one of three ways:

"It may transfer them to a new corporation in exchange for stock or cash; it may transfer them to the new corporation, the consideration being the payment by the new corporation of stock or cash to the stockholders of the old corporation; or the new corporation may buy with its stock and cash, from the stockholders of the old corporation, their stock, and then liquidate* the old corporation. If a corporation adopts the first method, its gain from the sale could be taxed. If it adopts the second method, the gain probably could be taxed on the theory of constructive receipt by the selling corporation. *If it adopts the third method there is no theory on which any gain to the old corporation could be taxed.*

"As a result of these considerations, subdivision (e) has been so drafted that *the tax liability on the selling corporation is the same, no matter which of the three methods set out above is adopted.* In other words, if the selling corporation is a mere conduit through which the consideration for the sale of the assets passes, or if the consideration for the sale of the assets is paid direct to the stockholders of the old corporation, without passing through the conduit, no gain or loss to the old corporation is recognized, and the same result is reached necessarily, as if the transaction were accomplished through the medium of a purchase by a new corporation of stock of the old corporation, followed by liquidation* of the old." (Italics ours.)

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* See the last paragraph in the opinion in *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, where it is held that dissolution is not necessary.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY, *Petitioner,*

vs.

GUY T. HELVERING, Commissioner of Internal Revenue, *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF OF PETITIONER

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BRIEF OF PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13) is reported in 34 B. T. A. 145.

The opinion of the Circuit Court of Appeals (R. 36) is reported in 89 Fed. (2d) 711.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 8, 1937 (R. 42). The petition for writ of certiorari was filed June 2, 1937, and was granted October 11,

1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

STATEMENT OF THE CASE

On August 23, 1928, pursuant to a plan of statutory reorganization (see *Helvering v. Minnesota Tea Co.*, 296 U. S. 378; *Minnesota Tea Co. v. Commissioner*, 76 F. (2d) 797), Minnesota Tea Company transferred all its property to the Grand Union Company, in exchange for 18,000 shares of the common stock (voting trust certificates) of the latter company, plus $426,842.52 in cash. Pursuant to the plan of reorganization, Minnesota Tea Company thereupon distributed all the cash to its stockholders, who assumed and agreed to pay, and later actually paid, liabilities of the petitioner to the extent of $106,471.73.

The resolution of the stockholders of the petitioner under which the cash was distributed is as follows:

> "Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders, whereby said stock-

holders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of Minnesota Tea Company whether due and payable or not and whether certain or contingent." (R. 28).

In his notice of deficiency (R. 7-12) the Commissioner of Internal Revenue proposed a deficiency of $11,587.64, on the theory that to the extent that liabilities of the petitioner had been assumed by the stockholders, the petitioner had not "distributed" the cash within the meaning of Section 112 (d) of the Revenue Act of 1928, and that taxable gain of $106,471.73, the amount of said liabilities, was therefore recognizable and taxable to the petitioner.

The matter was thereupon brought before the Board of Tax Appeals for review, upon the sole issue of whether or not the petitioner realized a taxable gain of $106,471.73 as a result of the transactions above set forth. No contention was made by the Government that the petitioner was taxable upon any greater sum than that amount. The Board of Tax Appeals, however, of its own motion, raised the question as to whether such statutory reorganization had been effected; and, in its decision, held that there was no reorganization, but a sale of assets, and that petitioner was taxable on the gain thereof. The case was then reviewed by the United States Circuit Court of Appeals for the Eighth Circuit, which (76 F. (2d) 797) reversed the Board of Tax Appeals in its conclusion on the reorganization question, and remanded the case to the Board of Tax Appeals for determination of the orginal issue. This Court granted certiorari (296 U. S. 562) on application of the Commissioner of Internal Revenue, and later affirmed the Circuit Court (296

U. S. 378). Upon affirmance by this Court, the Board of Tax Appeals, after a hearing pursuant to the mandate, in an opinion promulgated March 18, 1936, reported in 34 B. T. A. 145, (R. 13) held that the sum of $426,842.52 having been entirely distributed to the shareholders pursuant to the plan of reorganization, and in conformity to the reorganization provisions of the Revenue Act of 1928, no part thereof may be regarded as recognizable gain to the corporation, notwithstanding the assumption by the shareholders of the corporate debts.

Upon petition of the Commissioner of Internal Revenue, the Circuit Court of Appeals reviewed this second decision of the Board of Tax Appeals, and, reversing the Board, held (R. 36) that notwithstanding literal compliance with the statute, the payment of the corporate debts by the stockholders under the circumstances here presented resulted in taxable gain to the corporation, up to $106,471.73, the amount of said debts. Certiorari was granted by this Court October 11, 1937.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1) In holding that it is an exemption from taxation which is claimed by petitioner, and that upon it lies the burden of establishing the right thereto.

2) In failing to hold that it is the Government which claims an exemption from the operation of the statute, and upon it lies the burden of establishing such claim.

3) In holding that payment of the entire amount of cash received by Minnesota Tea Company from Grand Union Company to its stockholders in proportion to their

stockholdings was not a distribution within Sec. 112 (d) (1) of the Revenue Act of 1928.

4) In failing to hold that the transaction here involved constituted a compliance with Sec. 112 (d) (1) and hence that no gain should be recognized to the corporation.

5) In holding that the petitioner did not comply with Sec. 112 (d) (1) of the Revenue Act of 1928.

6) In holding that there was taxable gain to the petitioner by reason of the fact that its stockholders assumed and paid its liabilities.

7) In reversing the decision of the Board of Tax Appeals.

QUESTION PRESENTED

Whether the fact that stockholders assumed and paid certain indebtedness of a corporation upon distribution *pro rata* to the stockholders of all of the cash received by that corporation in a statutory reorganization, renders the corporation subject to tax on a gain, which otherwise would not be recognizable to it under the provisions of Sec. 112 (d) of the Revenue Act of 1928.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix.

ARGUMENT

It is, in effect, admitted by the respondent that the entire sum of $426,842.52, which was received by the petitioner

from the Grand Union Company, was distributed to the stockholders of the petitioner in literal compliance with the statute, Sec. 112 (d) (1), which reads:

> "If the corporation receiving such other property or money distributes it in pursuance of a plan of reorganization, no gain to the corporation shall be recognized from the exchange."

It is, however, the claim of the respondent that since the stockholders to whom the money was in fact distributed assumed and later paid debts of the corporation to the extent of $106,471.73, the latter amount cannot be regarded as having been "distributed" within the meaning of the statute. In other words, it is claimed that the actual distribution was converted to the extent of $106,471.73 into a constructive nondistribution. Accordingly, the respondent seeks to nullify literal compliance with the statute and claims exemption from its operation.

That the reorganization provisions of the Revenue Act do not grant an *exemption* from taxation is made clear in the report of the Ways and Means Committee in 1924 (Rep. No. 179, 68th Cong., 1st Sess., pp. 16-17) when discussing Sec. 203 (which corresponds to Sec. 112 of the 1928 Act), which reads in part as follow:

> "The provisions of Sec. 203 of the bill that no gain or loss is recognized from certain exchanges *do not grant an exemption and are not so intended.* These provisions are based upon the theory that the types of exchanges specified in Sec. 203 are merely changes in form and not in substance, and consequently should not be considered as effecting a realization of income at the time of the exchange. In other words, *these provisions result not in an exemption from tax but in a postponement of tax until the gain is realized by a pure sale or by such an exchange as amounts to a pure sale.* It follows, therefore, that in the case of such an exchange the property received should be considered as

taking the place of the property exchanged. If in connection with the exchange money is received which is not taxed, obviously the basis at which the old property is carried on the books of the taxpayer should be reduced to that extent, since the taxpayer has in part received a return of capital. But if money is received in connection with the exchange and the money is taxed, it is equally obvious that the basis of the old property should not be affected." (Italics Supplied)

We, therefore, say that the Court below is in error when it says in its opinion (R. 38): "It is an exemption from taxation which is here claimed by respondent (petitioner here) and upon it lies the burden of establishing the right thereto." Correctly viewed, it is the respondent here who seeks to depart from a recognition of the facts and to call the actual distribution, which was made in compliance with the statute, a constructive payment of the petitioner's debts by the petitioner itself. The burden, therefore, is not upon the taxpayer to establish its right to exemption, but upon the respondent to establish the Government's right to collect a tax upon the item in question.

While it is probably not a matter of paramount importance to the decision of this case, we submit that the Court below, for the reasons above stated, commences its reasoning with an erroneous premise.

Coming now to the merits of the case, it is the contention of the petitioner that since the entire amount of $426,842.52 received by it in a statutory reorganization was in fact distributed by it through a dividend to its stockholders, pursuant to the plan of reorganization, it not only complied with the literal wording of Sec. 112 (d) (1) of the Revenue Act of 1928, but has complied also with the true meaning and spirit of that section.

The terms of the statute, the terms of the applicable Regulations, the reports of the Committees of Congress and

the statement prepared by the Treasury at the time of enactment of the Revenue Act of 1924 (in which the provisions in question first appeared), all show (see Appendix) that when the cash is distributed to the stockholders pursuant to the plan of reorganization there is an end to the question of any gain being recognized to the company.

It is clear from the reports and statements above mentioned, as well as from the numerous decisions of this Court on the subject, that the dominant purpose of the reorganization statutes was to provide for an exemption from taxation (or, more accurately, a *postponement* of taxation) *at the time of a business reorganization,* of the gains involved therein to the extent specified in the statute, in order (1) to remove impediments to corporate readjustments, and (2) to prevent the recognition of mere paper profits or losses. *U. S. v. Hendler,* C. C. A. 4 (not yet officially reported), 374 C. C. H. Sec. 9448.

This dominant purpose is also shown in the Committee Reports accompanying the various Revenue Acts. Thus, at the time of enactment of the Revenue Act of 1921, which contained the first definition of "reorganization," the Senate Finance Committee reported as follows:

> "Under the existing law 'when property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any * * *.' Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustments * * *.
>
> "* * * The proposed act * * * specifies * * * certain classes of exchanges on which no gain or loss is recognized * * *.
>
> "The preceding amendments, if adopted, will, *by removing a source of grave uncertainty and by elimi-*

*nating many technical constructions which are economically unsound, * * * permit business to go forward with the adjustments required by existing conditions."* [1] (Italics Supplied)

Again, in reporting the 1924 Revenue Bill, which extended the reorganization provisions to situations not theretofore covered and which provisions were basically the same as those in the 1928 Act here involved, the Senate Finance Committee reported:

"Paragraph (3) provides that no gain or loss is recognized if a corporation a party to a reorganization exchanges property for stock or securities in another corporation a party to the reorganization. There is no corresponding provision of the existing law, although this paragraph embodies the construction placed by the Treasury Department upon the existing law. The present ruling of the Treasury Department on this question is of doubtful legality and a statutory provision is most necessary.

"Congress has heretofore adopted the policy of exempting from tax the gain from exchanges made in connection with a reorganization *in order that ordinary business transactions will not be prevented on account of the provisions of the tax law.* If it is necessary for this reason to exempt from tax the gain realized by the stockholders, it is even more necessary to exempt from tax the gain realized by the corporation." [2] (Italics Supplied)

In connection with the 1924 Bill, the Ways and Means Committee also reported:

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1 Rep. No. 275, 67th Cong., 1st Sess., pp. 11-12. See also Ways and Means Committee Report, Rep. No. 350, 67th Cong., 1st Sess., p. 10.

2 Rep. No. 398, 68th Cong., 1st Sess., pp. 14-15. Similar remarks appear in the Ways and Means Committee, Rep. No. 179, 68th Cong., 1st Sess., p. 13.

"It appears best to provide generally that gain or loss is recognized from all exchanges and then except specifically and in definite terms those cases of exchange in which it is not desired to tax the gain or allow the loss. *This results in definiteness and accuracy and enables a tax-payer to determine prior to the consummation of a given transaction the tax liability that will result therefrom.*" [1] (Italics Supplied)

Again, in regard to the new paragraph (3) mentioned in the foregoing quotation from the Senate report, the Ways and Means Committee said:

"The statute should contain a definite rule on this question." [2]

As to the desire to disallow losses which otherwise would have been deductible, in reporting the 1921 provisions the Senate Finance Committee said the new provisions would considerably increase the revenue—

"by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges." [3]

It was therefore provided, first: that no gain should be recognized in the exchange of property solely for stock or securities in the transferee corporation; and second: that if the property received in exchange should also include other property or money (in addition to stock or securities), the gain should be recognized only to the extent that such other property or money was not distributed in pursuance of the plan of reorganization.

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1 Rep. No. 179, 68th Cong., 1st Sess., p. 13. See also the views of the Democratic Minority members of the Committee, at p. 77 of this report; the minority said—"We believe the law should be made definite and specific so every taxpayer will know under the law his rights and will not be required to have his tax adjudicated upon the discretion of the Treasury officials." See also Senate Finance Committee, Rep. No. 398, 68th Cong., 1st Sess., p. 14.

2 *Ibid.*, at p. 13.

3 Rep. No. 275, 67th Cong., 1st Sess., pp. 11-12. See also Ways and Means Committee, Rep. No. 350, 67th Cong., 1st Sess., p. 10.

In corporate mergers and reorganizations, the assumption of liabilities and the payment of debts is a very usual feature. The real value which the grantor corporation owns is the *equity* in its corporate property, i. e., the value of its assets after the debts have been paid or provision made therefor; and that equity is what the grantee acquires in a corporate reorganization. The disposition of the liabilities of the grantor corporation is the means by which it is enabled to acquire title to the grantor's property, free from the claims of creditors. The principal purpose and object of the negotiations leading up to the plan of reorganization is to reach an agreement or establish a basis as to the price to be paid for the *net* value of the stock or property to be transferred. When this has been done, it is largely a matter of legal detail and selection of mechanics as to the method by which the debts are paid. The more frequent ways in which this is done are:

1) The transferee may pay the transferor only the net worth of the assets and assume the liabilities (as was done in *U. S. v. Hendler,* supra, and in some of the other cases hereinafter cited);

2) The transferor, before the actual transfer, may pay its own debts;

3) The transferee may pay the transferor the gross value of its assets but require the liabilities to be paid by it later from the cash received from the transferee; or,

4) The transferor may require its stockholders to pay the corporate debts (as in this case).

The financial result to the transferor is exactly the same in all four cases, and the tax result should be the same in all four cases. Otherwise confusion and uncertainty arise in the operation of the reorganization provisions of the income tax law, in that the taxpayer can never be certain

whether, notwithstanding compliance with the statute, he may be held to have rendered himself liable to tax by selecting the wrong method of compliance.

There are numerous decisions where the transferee corporation has assumed liabilities of the transferor and where reorganizations involving this feature were held to be nontaxable without discussion of the point: *Coleman v. Commissioner,* 81 F. (2d) 455, 456; *G. & K. Mfg. Co. v. Commissioner,* 76 F. (2d) 454 (C. C. A. 4); reversed 296 U. S. 389, and remanded to the Board of Tax Appeals; *Starr v. Commissioner,* 82 F. (2d) 964, (C. C. A. 4); certiorari denied, 298 U. S. 680; *Watts v. Commissioner,* 75 F. (2d) 981 (C. C. A. 2), affirmed 296 U. S. 387; *Tulsa Oxygen Co. v. Commissioner,* 18 B. T. A. 1283; *Frank Keel,* 31 B. T. A. 212; *National Pipe & Foundry Co. v. Commissioner,* 19 B. T. A. 242; and in the *Hendler* case (supra), the Circuit Court of Appeals for the Fourth Circuit directly decides the point and expressly disagrees with the opinion of the Court below in the instant case, insofar as it is at variance with the views expressed in the opinion in the *Hendler* case.

As said above, the ultimate financial effect upon the corporation in the cases last cited (where the transferee corporation assumed the indebtedness) is precisely the same as in the present case (where the stockholders assumed it). If the decision of the Court below is not reversed, the tax result will be different and taxability made to depend entirely on the machinery selected, rather than upon compliance or non-compliance with the statute,—a result which is not only not in harmony with the avowed purpose of the Act, but which wholly disregards the plain wording of the statute.

The price paid for the transferor's assets by the transferee includes both the value which passes to the transferor or its stockholders and that which passes to its creditors;

and the entire profit will be recognized when, upon the ultimate sale or liquidation of the assets actually received by the corporation or its stockholders, a comparison is made between that which was originally put into the venture and that which has been finally taken out, as the Court says in *U. S. v. Hendler,* supra. Further that Court says:

> "Now it seems to us, bearing in mind the general purpose of the statute, that it was not the intention of Congress to recognize for immediate taxation the gain derived in a corporate reorganization to the extent it should consist of an assumption of the debts of the corporate grantor. Such an assumption is undoubtedly an asset of value and may fairly be called property in the broad sense; but the money spent in the performance of the promise passes to creditors and does not come into the possession of the debtor corporation or its stockholders. It reduces the debts and therefore frees the assets from the claims of creditors so that they may be lawfully distributed amongst the stockholders or otherwise disposed of; but it does not increase in their hands the assets whose liquidation brings about the actual enjoyment of the realized profit. Therefore the recognition of the gain, to the extent of the amount of the debt assumed, would not serve the statutory purpose, but on the contrary would tend to defeat it. It is a matter of common knowledge that a promise by the grantee to assume the debts of the grantor corporation is a customary incident of reorganization agreements, and where the transaction yields a profit to the grantor, taxable gain up to the amount of the assumed debt would accrue in the current year if the present contention of the Commissioner is correct, whether or not at that time the corporation or its stockholders had actually realized the profit in the transaction."

As appears in "Statement of Changes in the Revenue Act of 1921 by the Treasury Department and the Reasons Therefor," prepared for the use of the Ways and Means

Committee by A. W. Gregg, Special Assistant Secretary of the Treasury (see Appendix), Sec. 112 (d) was included in the law in order that the tax results in the case of acquisition of *stock* of a transferor corporation, and in the case of acquisition of *properties* of the transferor corporation, should be the same, where there is a statutory reorganization. It was therefore provided that where the corporation was a mere conduit, as here, for passing the proceeds of the sale to the ultimate owners, no recognizable gain should be deemed to accrue to the corporation.

To illustrate: If the reorganization here had been consummated by the Grand Union's acquisition of the *stock* of the petitioner from its stockholders, and as a part of that transaction the petitioner's stockholders had assumed certain liabilities of the petitioner which the acquiring corporation did not wish to assume, there would be no question but that no taxable gain could be deemed to occur to the petitioner. However, instead of handling the transaction in that way, the parties effected the reorganization by means of an acquisition by the Grand Union Company of the *properties* of petitioner. In connection with the acquisition of the properties, it was considered desirable by the parties, in order to carry out the plan and eliminate the necessity of selling part of the Grand Union stock, that the stockholders of the petitioner should assume certain liabilities of the petitioner. Exactly the same business result was effected as would have been the case had the Grand Union Company acquired the stock of the petitioner, instead of its assets.

If the decision of the Court below is correct, the tax result cannot be the same in cases of stock acquisition as in cases of property acquisition; and if the results are not the same in the two types of reorganization, the intention of Congress is not given effect.

If the Grand Union Company had assumed and paid the liabilities of the petitioner and had given the latter only $320,370.79 instead of $426,842.52, the result to the petitioner would be exactly the same as it finally was. But, as above stated, the Circuit Court of Appeals of the Fourth Circuit in *U. S. v. Hendler*, supra, has held that the assumption or payment of liabilities of the transferee corporation is not "other property or money" within the meaning of Sec. 112 (d), and accordingly the petitioner would not in such case be liable for tax on the amount of the indebtedness assumed. In other words, that Court rightly refused to view the matter as though the transferor had constructively received the amount of the debts which it did not distribute.

Moreover, if the view that assumption of indebtedness is the equivalent of cash should prevail, then the acquisition by one corporation of substantially all the properties of another in return for voting stock plus the assumption of liabilities of the transferring corporation, would not be a reorganization within the statutory definition, since the acquiring corporation would not give "solely" its voting stock in return for the assets. Any such result, we submit, would be unsound and out of harmony with the purpose of the reorganization provisions and would be out of harmony with many of the decided cases, including the most recent decision of the Circuit Court of Appeals for the Fourth Circuit, in the *Hendler* case.

So here, where the result to the transferring corporation was precisely the same as in the example last above cited, consistency demands a similar tax result. The petitioner here should not be penalized for choosing one method of compliance with the statute in preference to another.

The Court below in substance has held, and the respondent asks this Court to hold, that since the financial

result of the transaction to the petitioner was the same as though the latter had first paid its debts and then distributed the balance of the cash, the petitioner should be taxed on that basis. If this Court is to disregard what was actually done and base its holding on the *effect* of what was done, then it would be as proper and logical to say that since the effect or financial result of what was done was precisely the same as though the Grand Union Company (the transferee) had assumed and paid the petitioner's debts, and that since the latter arrangement would not have resulted in recognizable gain to the petitioner (*U. S. v. Hendler*, supra), the tax effect should be the same where the stockholders of the transferor paid the debts (as in the instant case). In other words, if the tax is to be determined by the *effect* of what was done, there is no more reason to favor one process of arriving at that effect more than the other.

It is not a sufficient answer to say that in this case the tax must be imposed, otherwise a gain will escape taxation. The net gain to the corporation is not evidenced by money used to pay corporate debts, but by what it *retains* or *fails* to *distribute* to its stockholders; and when the money is distributed, it becomes ultimately liable to proper taxation on gain actually realized. The intent and effect of the statute, therefore, is to postpone rather than to exempt from taxation.

To support the contention of the petitioner, it is not necessary to establish that the kind of distribution referred to in the statute includes a distribution to creditors, as well as to shareholders, although there are sound arguments to support this contention, and many eminent tax authorities favor this view, as, for example, *Montgomery Federal Tax Handbook*, 1936-1937, p. 218; *Paul & Mertons Law of Federal Income Taxation*, Vol. 2, Secs. 17, 102; *Miller, Reorganizations and other Exchanges in Income Taxation*, Sec. 134.

In this connection, the discussion of the lower Court in the *Hendler* case, 17 Fed. Supp. 558, is most persuasive, particularly the following language:

> "Two thoughts are clearly expressed in section 112 (d). One is that money or property received by the corporation and distributed in pursuance of the plan is not taxable to the corporation; the other is that money or other property so received and not so distributed, is taxable. Here the antithesis seems to be on distribution or retention by the corporation, and not distribution to stockholders or creditors. A third situation (the one with which we are here dealing) must be determined by a construction of the word 'distribute' as used in the statute. Does it necessarily cover only a distribution *to stockholders?* The statute does not so say and the construction contended for by the defendant reads into the statute words ('to the stockholders') which do not expressly appear therein; and in so doing reads out of the statute (or at least gives little significance to) the phrase 'in pursuance of the plan of reorganization.' The construction must be within and not without the words of the statute, and should if possible be consistent with the purpose of the enactment.
>
> * * * * *
>
> "There is no lexicological difficulty involved in including creditors within the scope of 'distribute' as used in the section under consideration. It might possibly be considered inapt to use the word if the distribution were limited to creditors only, because 'distribute to creditors' is such a familiar phrase in bankruptcy and insolvency, where it most often implies something less than payment in full. But there is no linguistic infelicity in the phrase 'distribute in pursuance of the plan of reorganization *among creditors and stockholders,*' because what is implied is a division of the whole fund between two classes, in accordance with

their respective rights. Indeed it would be difficult to select a more appropriate word than 'distribute' in this connection. (Cf. Baar & Morris, Hidden Taxes in Corporate Reorganizations, supra, p. 266.)

"Counsel for the defendant points out that in other related sections of the statute (112 (g) and 115) Congress has expressly limited 'distribution' as there used to stockholders; but this sign post for construction at best points two ways, because in those sections the words 'to stockholders' were imperatively required by the subject matter, which related to the taxation of the individual stockholders, while the section now being considered (112 (d)) relates to the corporation itself, as distinct from its stockholders, and in this connection the word distribute was not followed by the words 'to stockholders.' By contrast its omission in this section may be regarded as significant. Of course, to be nontaxable, the money must have been distributed in accordance with the plan of reorganization. We are not considering a situation where money is received and retained by a corporation for its general corporate purposes.

* * * * *

"I conclude, therefore, that money received by the corporation, and applied in pursuance of the plan of reorganization to the payment of debts is not to be treated as a taxable gain to the corporation."

In the Court below, the respondent relied upon *West Texas Refining and Developing Co. v. Commissioner*, 68 F. (2d) 77, as holding that "the 'distribution' referred to by the statute is a distribution to stockholders, and not to creditors of the corporation." In that case it was briefly stated by the Court that in a reorganization, money received by a corporation which is used to pay debts and not distributed to stockholders, is taxable, as otherwise a realized gain

would escape taxation. There was no further discussion, probably because on the main point of the case the transaction was held not to be a reorganization, but a sale. The decision was in 1933, prior to the decisions of this Court in *Helvering v. Minnesota Tea Co.*, 296 U. S. 378; *Helvering v. Watts*, 296 U. S. 387; *G. & K. Mfg. Co. v. Helvering*, 296 U. S. 389, and *Nelson Co. v. Helvering*, 296 U. S. 374. But even though it should ultimately be held that a direct payment by a corporation to its creditors of cash received in a statutory reorganization is not a "distribution" within the intendment of the law, such a proposition, as said by the Board of Tax Appeals in its opinion in the present case (R. 17), "does not carry the corollary that the shareholders' promise to discharge the corporation's current debts had the same effect and changes the distribution made to them into a discharge by the corporation of its debts, converting, so to speak, the actual distribution *pro tanto* into a constructive nondistribution."

CONCLUSION

Petitioner accordingly respectfully submits that it exchanged all its property for stock of a corporation, a party to the reorganization, plus money; that it immediately distributed all the money in pursuance of a plan of reorganization; that both the wording and the spirit of the statutes

and regulations have been complied with, and that the petitioner realized no taxable gain under the statute.

The decision of the Court below, therefore, should be reversed.

Respectfully submitted,

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APPENDIX

Statutes Involved.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. *Determination of Amount of Gain or Loss.*

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. *Recognition of Gain or Loss.*

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the

plan of reorganization, solely for stock or securities in another corporation a party to the reorganization."

* * * * *

(d) *Same—Gain of Corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but—

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

Article 575 of Reg. 74 (1928 Act) provides in part:

> * * * If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to the reorganization, for stock or securities in another corporation, a party to the reorganization and other property or money, then, if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case, no loss from the exchange will be recognized. (See Sec. 112 (e).)

The provision in question first appeared in the Revenue Act of 1924, as to which the Ways and Means Committee (Rep. M. 179, 68 Cong. 1st Sess., p. 15) reported as follows:

> "There is no provision of the existing law which corresponds to subdivision (d) of the Bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization transfers its assets to another corporation a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss (sic) to the transferor is recognized, if it distributes the cash to its stockholders. But if the selling corporation fails to distribute the cash to its stockholders, then the gain or loss (sic) is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is to be recognized,

but if it retains all or any part of the proceeds with the result that the transaction is in substance a real sale, then all or part of the gain shall be recognized."

The provision was further explained in "Statement of the Changes in the Revenue Act of 1921 by the Treasury Department, and the Reasons Therefor," prepared for the use of the Ways and Means Committee, by A. W. Gregg, Special Assistant to the Secretary of the Treasury, printed in full in the New York Times for January 5, 1924:

"A corporation in connection with a reorganization may make distribution of its assets in one of three ways:

"It may transfer them to a new corporation in exchange for stock or cash; it may transfer them to the new corporation, the consideration being the payment by the new corporation of stock or cash to the stockholders of the old corporation; or the new corporation may buy with its stock and cash, from the stockholders of the old corporation, their stock, and then liquidate* the old corporation. If a corporation adopts the first method, its gain from the sale could be taxed. If it adopts the second method, the gain probably could be taxed on the theory of constructive receipt by the selling corporation. *If it adopts the third method there is no theory on which any gain to the old corporation could be taxed.*

"As a result of these considerations, subdivision (e) has been so drafted that *the tax liability on the selling corporation is the same, no matter which of the three methods set out above is adopted.* In other words, if the selling corporation is a mere conduit through which the consideration for the sale of the assets passes, or if the consideration for the sale of the assets is paid direct to the stockholders of the old corporation, without passing through the conduit, no gain or loss to the old corporation is recognized, and

the same result is reached necessarily, as if the transaction were accomplished through the medium of a purchase by a new corporation of stock of the old corporation, followed by liquidation* of the old." (Italics ours.)

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* See the last paragraph in the opinion in *Helvering v. Minnesota Tea Co.*, 296 U. S. 378, where it is held that dissolution is not necessary.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 13–19) is reported in 34 B. T. A. 145. The opinion of the Circuit Court of Appeals, filed April 7, 1937 (R. 36–41), is not yet reported.

JURISDICTION

The decree of the Circuit Court of Appeals was entered April 8, 1937 (R. 42). The petition for a writ of certiorari was filed June 2, 1937. The jurisdiction of this Court is invoked under Section 240

(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether cash received in a statutory reorganization by petitioner, and turned over to its stockholders in consideration of their assumption and payment of petitioner's debts, must be regarded as "distributed" in pursuance of the plan of reorganization, within the meaning of Section 112 (d) (1) of the Revenue Act of 1928, thus relieving from taxation to petitioner the gain included therein.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 11–12.

STATEMENT

Upon its first consideration of the stipulated facts of this case the Board of Tax Appeals held, in *Minnesota Tea Co.* v. *Commissioner*, 28 B. T. A. 591, that there was no statutory reorganization, and that therefore a consideration of the taxpayer's contest of the Commissioner's original determination of deficiency was precluded. This original determination was based upon the issue presently involved. Upon appeal by the taxpayer, petitioner herein, the Circuit Court of Appeals for the Eighth Circuit held, in *Minnesota Tea Co.* v. *Commissioner*, 76 F. (2d) 797, that a statutory reorganization had been effected within the meaning

of Section 112 (i) (1) (A) of the Revenue Act of 1928, reversed the decision of the Board, and remanded the case for consideration of the original issue. The decision of the Circuit Court of Appeals was affirmed by this Court in *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378. (R. 13–14.)

The Commissioner determined that cash received by petitioner in a statutory reorganization in the sum of $426,842.52, and immediately distributed to its stockholders, was, to the extent of $106,471.73, a distribution for the benefit of creditors, since the stockholders were required to pay corporate debts in that amount; and therefore that the cash was, to that extent, not distributed in pursuance of the plan of reorganization within the meaning of Section 112 (d) (1), Revenue Act of 1928. The Commissioner accordingly included the sum of $106,471.73 as profit on disposition of assets and computed the tax on that basis. (R. 10–12.)

The stipulated facts show that petitioner formed or caused to be formed on July 14, 1928, the Peterson Investment Company and transferred to it certain assets in exchange for the entire capital stock of the latter (R. 8, 36). Subsequently, on August 23, 1928, petitioner transferred all its remaining assets to Grand Union Company for 18,000 shares of Grand Union Company stock and $426,842.52 in cash (R. 8, 14). In the transfer to or exchange with Grand Union Company, petitioner was committed, by a resolution adopted the previous day,

immediately to turn over to its stockholders, who were three in number, the cash it received in the exchange. The resolution is as follows (R. 8–9, 14, 31):

> Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock and securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of Minnesota Tea Company whether due and payable or not and whether certain or contingent.

The money was turned over by petitioner to its three stockholders. Its corporate debts amounted to $106,471.73. The evidence does not contain the written agreement required by the resolution, but it is stipulated that the amount of the liabilities was assumed and discharged by the shareholders. (R. 14.) The stockholders themselves were creditors of petitioner in the aggregate sum of $6,524.10 and these debts were paid by means of the stockholders retaining out of the first cash received the respective amounts due them (R. 9).

The Board of Tax Appeals held that the provisions of the resolution with respect to distribution of cash by petitioner and the agreement by the stockholders to assume the debts were not conditioned upon each other, that there was an express distribution of all the cash among the shareholders within the literal language of the statute, that the dominating purpose of the reorganization provisions of the statute is illusive, and, upon these grounds, reversed the determination of the Commissioner (R. 15–18). In a dissent, six members of the Board expressed the opinion that the distribution was expressly conditioned upon the assumption of the corporate debts by the stockholders and that they took the distribution subject to this condition. The minority also felt that this transaction, for tax purposes, was not essentially different from a situation where the corporation had dis-

charged its debts directly with cash received in a reorganization (R. 18–19).

The Circuit Court of Appeals reversed the Board. Construing the resolution under which the cash received in the statutory reorganization was distributed to the stockholders, the court held that "the payment of this indebtedness by the stockholders was a condition attached to and governing the distribution;" futher, that petitioner "received the full benefit of this payment to the same extent as though it had retained that amount from distribution and applied it to payment of such indebtedness; * * *" (R. 40–41). Accordingly, it concluded that there was not a genuine distribution of the sum of $106,471.73, but rather a circuitous retention and application thereof by petitioner. The case was remanded to the Board for a determination of the gain in accordance with the opinion. (R. 41.)[1]

ARGUMENT

The narrow question presented in this case is whether a portion of the cash received by petitioner in an exchange constituting a statutory reorganization is exempt from taxation in its hands when distributed to its stockholders upon the condition

[1] The basis of the assets transferred by petitioner to the Grand Union Company was $199,016.09 (R. 12). It appears, therefore, that since petitioner recovered more than this sum in the cash payment received of $426,842.52, the entire amount of $106,471.73, the total of corporate debts paid, is includable in petitioner's gross income for the taxable year.

that the latter assume and pay all the corporate debts of petitioner.

The corporate debts so discharged under the method arranged amounted to $106,471.73. The court below held that to the extent of the debts paid the distribution to the stockholders by petitioner was not a genuine distribution but a circuitous retention and application of a part of the distribution for the payment of corporate debts (R. 41). In other words, the court held that petitioner merely used its stockholders as a conduit for payment of its debts, and gain realized and used for this purpose cannot escape taxation under the reorganization provisions of the statute.

Section 112 (d) (1) and (2) of the Revenue Act of 1928, *infra,* provides that if the corporation receiving money in a statutory reorganization "distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but * * * If the corporation receiving such * * * money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, * * *."

Under these provisions the entire amount of cash received by petitioner (less the cost basis of the transferred assets), if not distributed to its stockholders in pursuance of the plan of reorganization, would have constituted a realization of the gain upon the exchange to that amount and would have

been taxed accordingly; and furthermore, if the entire amount had been distributed absolutely to the stockholders, they, and not petitioner, would have been subject to taxation upon the gain realized.

But in the instant case, as pointed out by the court below (R. 40–41), petitioner, by its conditional distribution, accomplished the payment of its debts just as if it had actually retained that amount from the distribution and applied it to the payment of the indebtedness. Under either plan—i. e., either the method adopted in this case or the actual retention of the sum and its application to the indebtedness by petitioner, followed by the distribution of the balance to the stockholders—the result would have been the same both as to petitioner and its stockholders, for in either case not only would the indebtedness have been satisfied, but there would have been distributed to the stockholders for their own use the same amount in the end. Here the corporation was not a conduit for the stockholders, but the stockholders were a conduit for the corporation. Certainly, in the circumstances, the Circuit Court of Appeals was justified in deciding that there was not the kind of distribution contemplated by the statutory provision granting an exemption to a distributing corporation. What was actually a payment of corporate indebtedness may not be translated into a tax-free distribution to stockholders merely be-

cause the payment of the indebtednes was made or routed through the stockholders. Cf. *Gregory* v. *Helvering,* 293 U. S. 465, 469.

While the precise question decided below and presented by the petition has not been passed upon by another Circuit Court of Appeals, in principle the decision below is in harmony with *West Texas Refining & D. Co.* v. *Commissioner,* 68 F. (2d) 77, 80 (C. C. A. 10th), and *Liquidating Co.* v. *Commissioner,* 33 B. T. A. 1173, which hold that the "distribution" referred to by the statute is a distribution to stockholders and not to creditors of the corporation.

None of the cases cited by petitioner (Pet. 7, 9) considered or decided the question whether cash received by a corporation in a statutory reorganization was distributed in accordance with Section 112 (d), Revenue Act of 1928, *infra,* or corresponding provisions of the other revenue Acts. *Hendler* v. *United States,* 17 F. Supp. 558, decided by the United States District Court for the District of Maryland on December 30, 1936, involved the question of whether the assumption and payment of liabilities of a transferor corporation by the transferee corporation, both being parties to a statutory reorganization, constituted the receipt by the transferor of "other property or money" under the reorganization provisions. That case is now pending on appeal in the Circuit Court of Appeals for the Fourth Circuit.

CONCLUSION

The decision below is correct. The question involved is not of general importance and there exists no conflict among the Circuit Courts of Appeals. The petition should therefore be denied.

Respectfully submitted.

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JULY 1937.

APPENDIX

STATUTES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of

subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

* * * * *

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13–19) is reported in 34 B. T. A. 145. The opinion of the Circuit Court of Appeals (R. 36–41) is reported in 89 F. (2d) 711.

JURISDICTION

The decree of the Circuit Court of Appeals was entered April 8, 1937. (R. 42.) The petition for a writ of certiorari was filed June 2, 1937, and was granted October 11, 1937. (R. 43.) The jurisdic-

tion of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether cash received in a statutory reorganization by petitioner, and turned over to its stockholders in consideration of their assumption and payment of petitioner's debts, must be regarded as "distributed" in pursuance of the plan of reorganization, within the meaning of Section 112 (d) (1) of the Revenue Act of 1928, thus relieving from taxation to petitioner the gain included therein.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 27–32.

STATEMENT

The stipulated facts show that petitioner formed or caused to be formed on July 14, 1928, the Peterson Investment Company and transferred to it certain assets in exchange for the entire capital stock of the latter, which was immediately distributed to the stockholders of petitioner (R. 8, 36). Subsequently, on August 23, 1928, petitioner transferred all its remaining assets to Grand Union Company for 18,000 shares of Grand Union Company stock and $426,842.52 in cash. (R. 8, 14.) In the transfer to or exchange with Grand Union Company, petitioner was committed, by a resolution adopted the previous day, immediately to turn

over to its stockholders, who were three in number, the cash it received in the exchange. The resolution is as follows (R. 8–9, 14, 31):

> Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company whether due and payable or not and whether certain or contingent.

The money was turned over by petitioner to its three stockholders. Its corporate debts amounted

to $106,471.73. The evidence does not contain the written agreement required by the resolution, but it is stipulated that the amount of the liabilities was assumed and discharged by the shareholders (R. 14). The stockholders themselves were creditors of petitioner in the aggregate sum of $6,524.10 and these debts were paid by means of the stockholders retaining out of the first cash received the respective amounts due them (R. 9).

The Commissioner determined that cash received by petitioner in a statutory reorganization in the sum of $426,842.52, and immediately distributed to its stockholders, was, to the extent of $106,471.73, a distribution for the benefit of creditors, since the stockholders were required to pay corporate debts in that amount; and therefore that the cash was, to that extent, not distributed in pursuance of the plan of reorganization within the meaning of Section 112 (d) (1), Revenue Act of 1928. The Commissioner accordingly included the sum of $106,471.73 as profit on disposition of assets and computed the tax on that basis (R. 10–12).

Upon its first consideration of the stipulated facts of this case the Board of Tax Appeals held, in *Minnesota Tea Co.* v. *Commissioner,* 28 B. T. A. 591, that there was no statutory reorganization, and that therefore a consideration of the taxpayer's contest of the Commissioner's original determination of deficiency was precluded. Upon appeal by the taxpayer, petitioner herein, the Circuit Court of Appeals for the Eighth Circuit held, in

Minnesota Tea Co. v. *Commissioner,* 76 F. (2d) 797, that a statutory reorganization had been effected within the meaning of Section 112 (i) (1) (A) of the Revenue Act of 1928, reversed the decision of the Board, and remanded the case for consideration of the original issue. The decision of the Circuit Court of Appeals was affirmed by this Court in *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378 (R. 13–14).

The Board of Tax Appeals on its second consideration of the case held that the provisions of the resolution with respect to distribution of cash by petitioner and the agreement by the stockholders to assume the debts were not conditioned upon each other, that there was an express distribution of all the cash among the shareholders within the literal language of the statute, that the dominating purpose of the reorganization provisions of the statute is elusive, and, upon these grounds, reversed the determination of the Commissioner. (R. 15–18.) In a dissent, six members of the Board expressed the opinion that the distribution was expressly conditioned upon the assumption of the corporate debts by the stockholders and that they took the distribution subject to this condition. The minority also felt that this transaction, for tax purposes, was not essentially different from a situation where the corporation had discharged its debts directly with cash received in a reorganization. (R. 18–19.)

The Circuit Court of Appeals reversed the Board. Construing the resolution under which the cash received in the statutory reorganization was distributed to the stockholders, the court held that "the payment of this indebtedness by the stockholders was a condition attached to and governing the distribution;" further, that petitioner "received the full benefit of this payment to the same extent as though it had retained that amount from distribution and applied it to payment of such indebtedness; * * *." (R. 40–41.) Accordingly, it concluded that there was not a genuine distribution of the sum of $106,471.73, but rather a circuitous retention and application thereof by petitioner. The case was ordered remanded to the Board for a determination of the gain in accordance with the opinion (R. 41).[1]

SUMMARY OF ARGUMENT

The scheme of the reorganization statute (Section 112, Revenue Act of 1928, *infra*) is not to permit the gain received from exchanges included therein to go unrecognized both to the corporation and its stockholders. In cases of stock and

[1] The basis of the assets transferred by petitioner to the Grand Union Company was $199,016.09 (R. 12). It appears, therefore, that since petitioner recovered more than this sum in the cash payment received of $426,842.52, the entire amount of $106,471.73, the total of corporate debts paid, is includable in petitioner's gross income for the taxable year.

securities received and held or distributed by the corporation there is a mere postponement of the tax thereon until a final disposition. Section 112 (b) (4) and (c). In cases of cash or other property received the gain realized by the corporation, not in excess of the sum of such money and the fair market value of such other property, is taxable to the corporation unless distributed by it in pursuance of the plan of reorganization. Section 112 (d) (1) and (2). The reason for not recognizing the gain to the corporation when so distributed is that its stockholders will pay a tax on the income thus received. Section 112 (c). The Board and the courts have uniformly held that a distribution by a corporation to its own creditors is not a distribution within the intendment of the statute.

Since it is apparent here that the distribution to the stockholders, to the extent they were required to pay corporate debts ($106,471.73), was not taxable to them, the gain realized by the corporation in that amount would escape taxation if it were treated as distributed in pursuance of the plan of reorganization. Accordingly, we submit, the conclusion below is in harmony with the purpose and intent of the reorganization statute; with the rule that the payment of an obligation by another is income to the one whose debt is liquidated; and with the principle that a taxpayer claiming an exemption must bring himself squarely within the intent as well as the language under which the exemption is claimed.

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Since this Court's decision in *Gregory* v. *Helvering,* 293 U. S. 465, the rule has been well settled that a mere literal compliance with the reorganization provisions will not render a gain, otherwise taxable, unrecognizable under that statute. Accordingly, it will not suffice for the petitioner here to point to a literal distribution to stockholders as that "which the statute intended."

The authorities relied upon by petitioner are not controlling in the instant case since they do not decide the question presented by the facts here involved.

ARGUMENT

THE TRANSFER OF CASH TO A CORPORATION'S STOCKHOLDERS UPON CONDITION THAT THE STOCKHOLDERS ASSUME PAYMENT OF THE CORPORATION'S DEBTS IN IDENTICAL AMOUNT, WHICH DEBTS ARE ACCORDINGLY ASSUMED AND PAID BY THE STOCKHOLDERS, IS NOT A "DISTRIBUTION" WITHIN THE MEANING OF SECTION 112 (D) OF THE REVENUE ACT OF 1928

Petitioner, in a statutory reorganization, exchanged its assets for Grand Union Company stock and $426,842.52 in cash. The stock was retained and the cash transferred to petitioner's stockholders. The stockholders agreed to assume payment of petitioner's debts amounting to $106,471.73, and did so pay them.

Section 112 (d) (1) and (2) of the Revenue Act of 1928, *infra,* provides that if the corporation

receiving money in a statutory reorganization "distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but * * * If the corporation receiving such * * * money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, * * *." The Commissioner did not seek to tax petitioner for the gain represented by the excess of $426,842.52 over $106,471.73, and the question in this case involves only the latter amount. Was the sum of $106,471.73 "distributed" by petitioner to its stockholders within the meaning of Section 112 (d) of the Revenue Act so as to exempt petitioner from taxation on the gain realized by the receipt of that sum upon the exchange of its assets? We submit that it was not so distributed.

First, there can be little question that the transfer of cash to the stockholders was expressly conditioned upon their assumption of payment of petitioner's debts. The resolution adopted at the stockholders' meeting which authorized the exchange of petitioner's assets stated (R. 31):

> Resolved further that all moneys received * * * shall be immediately distributed to the stockholders * * * *upon the assumption* by the stockholders of all the corporate debts * * *[2]

[2] Unless otherwise noted, all italics used herein are ours.

The resolution accordingly directed the board of directors "to distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders * * * whereby *said stockholders,* in consideration of such distribution * * *, *agree to pay* all the corporate debts of Minnesota Tea Company * * *"

The Board, treating the provision for "distribution" to the stockholders as independent of the provision for the stockholder's agreement to pay the corporate debts, intimated that the transfer was not conditioned upon the stockholders' assumption of debts (R. 15). But the two provisions are part of the same sentence, separated only by a comma. A dividend resolution "is to be taken as it emanates from the Board. A part of it cannot be taken and the rest discarded." *State* v. *Balt. & Ohio R. R. Co.*, 6 Gill (Md.) 363, 386. By the inseparable, express statement of the resolution, distribution was to be made to the stockholders "upon the assumption by the stockholders of all the corporate debts." And we believe it clear, as the court below held (R. 40–41) that "the payment of this indebtedness by the stockholders was a condition attached to and governing the distribution."

In any event, it cannot be disputed that upon receipt of $106,471.73 the stockholders immediately became obligated to pay corporate debts in like amount. It cannot be reasonably said that they re-

ceived any income from the receipt of that sum. This is particularly emphasized by the fact that corporate debts owing to petitioner's stockholders (R. 9) were of course immediately extinguished upon the transfer of cash to the stockholders. The stockholders could not be taxed on the sum received in payment of petitioner's debts. See R. 11. Petitioner contends nevertheless that the transfer of the cash resulted in an exemption to it from tax upon the gain realized upon the receipt of cash in the reorganization. The contention is contrary to the plain intent and purpose of the reorganization provisions immediately to tax gains realized in cash either to the corporation or to its stockholders.

The reorganization provisions do not permit gains resulting from transfers of stock or properties to go untaxed in the hands of the corporation and its stockholders. In the case of stock and securities received and held or distributed by the corporation there is a mere postponement of tax on the gain on the exchange until there is a final disposition of the stock and securities.[3] But the gain represented by cash or other property, so called "boot", is immediately taxable. Section 112 (c) (d), *infra;* see H. Rep. No. 179, 68th Cong.,

[3] See quotation in petitioner's brief, pp. 6–7, from Report of House Ways and Means Committee, 1924, when the pertinent provisions of the reorganization statute were revised and adopted. H. Rep. No. 179, 68th Cong., 1st Sess., pp. 16–17.

1st Sess., pp. 14–15; S. Rep. No. 398, 68th Cong., 1st Sess., pp. 15–16. Cash or other property received by the corporation is expressly taxed to it unless distributed "in pursuance of the plan of reorganization." Section 112 (d). If the cash is so distributed, the corporation pays no tax thereon, but the cash is taxable to the distributee stockholders under the explicit language of Section 112 (c). That provision deals with the distributee and prescribes the manner in which he shall account for his share of the distribution. In his hands it is taxed in one of two ways: (1) The portion which represents the distributive share of the corporate earnings since February 28, 1913, is taxed as a dividend (except in the rare case where the distribution does not have "the effect of the distribution of a taxable dividend," as, for example, in cases under Section 104 (d) of the Revenue Act of 1928); and (2) the balance is taxed as gain upon an exchange. If it is deemed that Section 112 (c) is not applicable to cash distributed to stockholders in an exchange under Section 112 (b) (4), nevertheless such receipt of cash is taxable to stockholders under the general income provisions of Section 22 (a). This is clearly so since Section 112 (d) provides an exemption for the *corporation* if cash is distributed, but neither in Section 112 (d) nor in any other section of the Act is there a provision exempting stockholders from taxation upon

cash distributed to them by the corporation under Section 112 (d).

Here the stockholders could not be taxed,[4] and upon petitioner's theory the gain realized in cash would be taxable neither to the corporation nor the stockholders. But Congress was interested in relieving the corporation from tax only if the stockholders were to be subject to a tax instead. A construction of the statute which results in an exemption from tax by both appears inadmissible.

It would seem that the term "distributes" in Section 112 (d) is used in the same sense as in Section 115 (a). There the term "dividend" is defined as "any distribution made by a corporation to its shareholders * * *". When, as here, "distributes" is applied to a corporation, it can only mean a distribution to stockholders, in their capacity as stockholders, for their own separate use and benefit. Cf *Eisner* v. *Macomber*, 252 U. S. 189, 207, 211.

The committee reports are clear on this point. Section 112 (d) was first included in the Revenue Act of 1924, c. 234, 43 Stat. 253, as Section 203 (e). H. Rep. No. 179, *supra*, states (p. 15):

> SECTION 203 (e): There is no provision of the existing law which corresponds to subdivision (e) of the bill, nor has the Treasury Department ever ruled officially on the type of case covered by that subdivision. The subdivision provides that if a corporation in connection with a reorganization trans-

[4] See p. 11, *supra*.

> fers its assets to another corporation, a party to the reorganization, for stock and securities of the same corporation and cash, then no gain or loss to the transferor is recognized, if it distributes the cash *to its stockholders*. But if the selling corporation fails to distribute the cash *to its stockholders* then the gain or loss is to be recognized. In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a *conduit* in passing the proceeds of the sale on *to its stockholders*, no gain to the corporation is to be recognized, but if it retains all or any of the proceeds with the result that the transaction is in substance a real sale, then all or a part of the gain shall be recognized.

The same explanation is found in the report of the Senate Committee on Finance (S. Rep. No. 398, 68th Cong., 1st Sess., p. 16). Here it cannot be said in any substantial sense that petitioner acted "merely as a conduit in passing the proceeds of the sale on to its stockholders;" or that petitioner "distributed" the cash in contradistinction to "retaining" it. The transfer of cash in the amount of $106,471.73 can not be treated separately from and independently of the condition, or at least the concurrent obligation, to pay corporate debts in equivalent amount. Viewed realistically, as principles of tax law and administration require, they were component parts of a single transaction designed to effect a single purpose—the payment of corporate debts. It is well settled that, for income tax pur-

poses, such "component steps of a single transaction cannot be treated separately." *Bassick* v. *Commissioner,* 85 F. (2d) 8, 10 (C. C. A. 2d), certiorari denied, 299 U. S. 592; *Starr* v. *Commissioner,* 82 F. (2d) 964 (C. C. A. 4th), certiorari denied, 298 U. S. 680; *First Seattle D. H. Nat. Bank* v. *Commissioner,* 77 F. (2d) 45, 48–49 (C. C. A. 9th); *West Texas Refining & D. Co.* v. *Commissioner,* 68 F. (2d) 77, 80 (C. C. A. 10th).

Indeed the stockholders acted as a conduit for the corporation in paying its creditors. The transaction does not differ in substance from a direct distribution by petitioner to its creditors in payment of its debts. As to debts owed to the stockholders, the transaction was even in form a direct distribution to creditors. There is no rational distinction between payment of the debts owed to petitioner's stockholders and payment of the debts owed to other creditors. But the statute means a distribution to stockholders, not to creditors; and the statute neither intends nor operates to transfer the tax due from the corporation to persons other than stockholders. H. Rep. No. 179, *supra;* S. Rep. No. 398, *supra.* The Board of Tax Appeals has so held. *Liquidating Co.* v. *Commissioner,* 33 B. T. A. 1173; cf. *Bancker* v. *Commissioner,* 31 B. T. A. 14. The same construction of the statute was adopted and applied by the Tenth Circuit Court of Appeals in *West Texas Refining and D. Co.* v. *Commissioner, supra.*

Moreover, the payment of a debtor's obligation by another results in income to the debtor. *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716; *United States* v. *Boston & M. R. Co.*, 279 U. S. 732; *Douglas* v. *Willcuts*, 296 U. S. 1. Assuming that the transfer to the stockholders is to be treated as a "distribution" within the meaning of the statute, it is clear that the payment of the corporate debts by the stockholders would result in a taxable gain of a different character to the corporation. Therefore, if petitioner's argument should prevail, petitioner escaped the tax upon the gain realized from the exchange, but as soon as the stockholders paid the corporate debts petitioner should have been chargeable with the receipt of income in the amount of cash so used. Such circumlocution could not have been intended by Congress. It would be pointless to decree an exemption upon the distribution for payment of corporate debts if the corporation would be subjected to tax, as soon as the cash distributed were so used.

As a matter of fact, in such a case the corporation might be subject to a larger tax than that for which it would have been liable if the transfer were held not to be a distribution within the meaning of the statute. Where a corporation retains the cash it is taxable only to the extent that the cash represents the gain upon the exchange. Section 112 (d) (2). That tax is imposed upon the gain realized from the transfer of its assets. Thus in

this case the $106,471.73 cash is taxable upon the Government's theory because the gain to the petitioner from the transfer of its assets was in excess of that amount. But if the transfer to the stockholders in such a case as this be treated as a distribution, then the subsequent payment of the corporate debts in the amount of $106,000 will represent income to the corporation in the amount of $106,000 irrespective of whether the corporation realized that much gain upon the exchange. For example, if petitioner's entire profit upon the transfer of its assets in this case had amounted to only $75,000, and the transfer of $106,000 to petitioner's stockholders be held to be a distribution, the result would be an avoidance by petitioner of a tax upon $75,000. However, if the stockholders then used the $106,000 to pay the corporate debts, the entire $106,000 would be chargeable to petitioner as taxable income.

Since the gain upon the transfer of its assets is the only gain with which Congress dealt in the reorganization statutes, there is no room for the contention that the income resulting from the payment of the corporate debts by the stockholders was also intended to be exempted. That would be a true exemption—a permanent exemption—and not the postponement or temporary exemption of tax which was intended by Congress in the reorganization statutes. H. Rep. No. 179, 68th Cong., 1st Sess., p. 16; S. Rep. No. 398, 68th Cong., 1st Sess., p. 17.

From the foregoing it appears that the acceptance of petitioner's argument means: (1) That Congress has exempted from tax the cash gain upon the exchange because it was "distributed" to the stockholders; (2) that Congress has immediately imposed a tax upon the corporation because the stockholders have discharged the corporate debts; and (3) that the second tax may in some cases be larger than the tax which was escaped. This is utterly illogical and petitioner's argument should be rejected. No such curious result flows from the adoption of the Government's contention. We submit there was no "distribution" in the substantial sense intended by Congress.

In seeking a reversal of the decision below petitioner asserts a literal compliance with Section 112 (d) (1), *infra,* since there was a physical transfer of the sum of $106,471.73 to its stockholders. It is argued from this that it is the Commissioner who seeks to depart from a recognition of the actual distribution and thus the burden is upon the Government to establish the taxability of the item in question. Such an argument, in the first place, ignores the well established rule that a mere literal compliance with the reorganization provisions will not suffice to obtain the benefits therein provided. *Gregory* v. *Helvering,* 293 U. S. 465, 469. In the second place, the argument fails to recognize that under the general rule of the reorganization statute (Section 112 (a), *infra*), the entire amount of the gain is taxable to the corporation and only in so

far as the transaction comes within one of the exceptions enumerated therein may the tax liability of the corporation be postponed or passed on to its stockholders. Since the petitioner here is claiming the benefit of one of these exceptions (Section 112 (d) (1), *infra*), there can be no doubt but that it must bring itself squarely within the intent as well as the language under which the benefit is claimed. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Gregory* v. *Helvering, supra.*

Like the inquiry in the *Gregory* case, the question here is whether the pertinent transaction, even if it were literally in accord with the statutory language, "was the thing which the statute intended." In that case it was earnestly contended on behalf of the taxpayer that since every element required by the statutory definition of reorganization contained in subdivision (B) of Section 112 (i) (1), *infra,* was present, the exchange there involved necessarily fell within the statutory scope. This Court, looking through the form of the transaction and giving effect to the real purpose as well as the result actually accomplished by the transfer, held (p. 470):

> In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of subdivision (B), ***was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization,*** and nothing else. The rule which excludes from con-

> sideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose. [Italics supplied.]

So, we say, in the instant case the distribution here, to the extent that the stockholders were required to pay the corporate debts, was a distribution, *pro tanto,* for the benefit of creditors; not a true distribution within the intendment of the statute. It may be taken to be *in fact an elaborate and devious form of conveyance masquerading,* in part, as a distribution to the stockholders. In order to constitute a true distribution, as demonstrated above, the distribution under Section 112 (d) (1) must result in income to the stockholders—something acquired by the stockholders for their own separate use and disposal. Such is not the result where the distribution carries a legal obligation to pay the corporate debts. Since the statute does not intend or provide that the cash shall go tax free to both the corporation and its stockholders, it follows that a distribution in form, but not in reality, is not sufficient to bring the transaction within the statute.

In this Court petitioner mainly relies upon the case of *United States* v. *Hendler*, 91 F. (2d) 680 (C. C. A. 4th), now pending on ~~petition for a~~ writ

of certiorari, No. 563, October Term, 1937. There, the Hendler Company in 1929 transferred all its assets to the Borden Company in exchange for 105,306 shares of the latter's capital stock, $43,-421.87 in cash, and assumption by Borden of all of Hendler's indebtedness. The Commissioner treated the transaction as a statutory reorganization and since the stock and cash had been immediately distributed by Hendler to its stockholders any gain thereon was treated as nonrecognizable to the corporation under the provisions of Section 112 (d) (1). The Commissioner, however, did assess to the Hendler Company and collect from its transferee a tax based upon the gain to Hendler represented by the assumption and discharge by Borden of a first mortgage bond issue of Hendler in the sum of $534,297.40.

Although expressly recognizing the rule that the payment of an obligation of a taxpayer by another person constitutes income to the taxpayer, the Fourth Circuit Court of Appeals held that if such assumption and discharge were made in connection with a statutory reorganization, no gain then was recognizable to the corporation whose debts were paid. While the basis of the decision is not entirely plain from the opinion, the court, in part, holds that the transferor in a reorganization agreement receives nothing from the assumption of its debts by the transferee that prevents it from claiming an exemption under either of the cited subsec-

tions (Section 112 (b) (4) and (d)) of the statute. Further, the court held that the price paid for the corporate assets by the transferee includes both the value which passes to the corporation or its stockholders and that which passes to its creditors; and that the entire profit will be recognized when upon the ultimate liquidation of the assets actually received by the corporation or its stockholders a comparison is made between that which was originally put into the venture and that which has been finally taken out.

This construction and application of the reorganization provisions, we believe, is contrary to the fundamental aim of the statute that no gain shall escape taxation and that only to the extent provided by Section 112 (d) will the cash or other property received by a transferor corporation not be recognized, the reason for such non-recognition being that if such property be distributed to its stockholders, they in turn will be liable for a tax thereon under Section 112 (c), or Section 22 (a)

Petitioner (Br. 11) sets forth various situations in which the debts of the transferor corporation are discharged in connection with a reorganization and urges that in all cases the tax result should be the same. The four situations suggested are: (1) The transferee pays the transferor only the net worth of the assets transferred and assumes payment of the transferor's debts (the *Hendler* case); (2) the transferor pays its debts before the

transfer is made; (3) the transferor pays its debts out of cash received from the transferee; and (4) the transferor conveys the cash received from the transferee to the transferor's stockholders and requires the stockholders to pay its debts (the present case).

Situation (2) involves a transfer of net assets only. In such a case no cash received as a consideration is used to pay debts and the question here presented under Section 112 (d) obviously cannot arise. (3) and (4) are alike in that the cash consideration is used to pay the corporate debts. It is our view that in either of those cases the corporation would be taxable under Section 112 (d) (2). In situation (1) (the *Hendler* case), we consider that there has been a constructive re-receipt of cash, and hence believe that the corporation would be likewise taxable. Thus the Government's theory is wholly consistent, and every comparable situation is treated uniformly.[5]

The *Hendler* decision reaches a result inconsistent with other comparable situations, which demonstrates, we believe, that the decision is erroneous. For example, if petitioner had used $106,000 of the total amount of cash received from the transferee and directly paid its debts (situation (3))

[5] There appear to be no published rulings on either the question here involved or on the question involved in the *Hendler* case. The Commissioner's action in the few cases in the Bureau of Internal Revenue which have presented similar questions has been in accord with his determination both in the *Hendler* case and here.

there could have been little question that petitioner would have been taxable upon gain in that amount (see pp. 13–15, *supra*). Petitioner's reliance upon the *Hendler* decision is then curiously inconsistent with its contention that a like tax should result in similar cases.

Regardless, however, of the ultimate result in the *Hendler* case, we submit that cash received by a corporation and not actually distributed to its stockholders so as to result in a tax on them is not a true "distribution" within the intendment of that term as used in Section 112 (d) (1).

As pointed out by the petitioner, *United States* v. *Hendler, supra,* is the only case which has directly passed upon the question of the effect of assumption and discharge of indebtedness of the transferor by the transferee corporation. Accordingly, *G. & K. Mfg. Co.* v. *Commissioner,* 296 U. S. 389, and the other cases cited at page 12 of petitioner's brief, are not persuasive, since the question was neither raised nor decided therein. "Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents." *Webster* v. *Fall,* 266 U. S. 507, 511; *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378, 380.

Finally, petitioner maintains (Br. 16) that it is not a sufficient answer to say that in this case the tax must be imposed, otherwise the gain will escape

taxation. We think that it is. Assuming that there is no intent in the reorganization statute to exempt the realized gain both to the corporation and its stockholders, no plausible reason has been suggested by the petitioner why such a result should be reached in the instant case. While seeking the legislative grace to be found in Section 112 (d) (1), petitioner has not plainly established its right thereto. This Court has remarked that a well founded doubt is fatal to such a claim. *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, 146; see *Gregory* v. *Helvering, supra; New Colonial Co.* v. *Helvering, supra.*

CONCLUSION

For the foregoing reasons, we respectfully submit the decision of the court below should be affirmed.

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DECEMBER 1937.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no

gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) *Loss from exchanges not solely in kind.*—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in

identity, form, or place of organization, however effected.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the

part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

Treasury Regulations 74:

ART. 575. *Exchanges in reorganizations for stock or securities and other property or money.*—If stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged for stock or securities in such corporation or in another corporation a party to the reorganization and other property or money, the gain, if any, to the recipient will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property. No loss from such an exchange will be recognized. (See section 112 (e).) If a distribution of property or money in the course of a reorganization is otherwise within the provisions of this paragraph, but has the effect of the distribution of a taxable dividend, there shall be taxed to each distributee (1) as a dividend, such an amount of the gain recognized under this paragraph as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and (2) as a gain from the exchange of property, the remainder of the gain recognized under this paragraph.

* * * * *

If, in pursuance of a plan of reorganization, property is exchanged by a corporation

a party to a reorganization for stock or securities in another corporation a party to the reorganization and other property or money, then, if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized. (See section 112 (e).)

U. S. GOVERNMENT PRINTING OFFICE: 1937

SUPREME COURT OF THE UNITED STATES.

No. 106.—October Term, 1937.

Minnesota Tea Company, Petitioner, *vs.* Guy T. Helvering, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit

[January 17, 1938.]

Mr. Justice Sutherland delivered the opinion of the Court.

Petitioner, in 1928, brought about the organization of the Peterson Investment Company, and transferred to it certain assets in exchange for the entire capital stock of that company. The stock was immediately distributed to petitioner's stockholders. Soon thereafter, petitioner transferred its remaining assets to Grand Union Company in exchange for 18,000 shares of that company's stock and $426,842.52 in cash. The cash was immediately transferred to and divided among petitioner's stockholders, in proportion to their stock holdings, in pursuance of a plan of reorganization. The Board of Tax Appeals, upon its first consideration of the case, held that no reorganization had been effected under § 112 (i) (1) (B) of the Revenue Act of 1928. 28 B. T. A. 591. The Circuit Court of Appeals concluded otherwise, reversed the Board, and remanded the case to the Board for further consideration. 76 F. (2d) 797. Upon review, pursuant to a writ of certiorari, we affirmed the judgment of the Circuit Court of Appeals. *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378.

Upon the remand, the Board, after consideration, refused to follow the ruling of the commissioner that $106,471.73 of the $426,842.52 constituted taxable assets in the hands of petitioner. 34 B. T. A. 145. The court below, reversing the action of the Board, sustained the view of the commissioner, 89 F. (2d) 711; and the case again comes here upon writ of certiorari. 302 U. S. —.

The facts are not in dispute. In addition to those already stated, it appears that immediately before the receipt by petitioner of the $426,842.52, its stockholders, at a special meeting, adopted the following resolution:

"Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof,

whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock or securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company whether due and payable or not and whether certain or contingent."

When the cash was "distributed", petitioner's debts amounted to $106,471.73, about $6,500 of which was owing to the stockholders themselves. In pursuance of the resolution, the stockholders paid all the debts, retaining sums, aggregating about $6,500, necessary to discharge the amount of petitioner's indebtedness to them.

The question for determination is whether the delivery of the $106,471.73 by petitioner to the stockholders, an equal sum thereafter being applied by them to the payment of petitioner's debts in pursuance of the resolution, constituted a distribution within the meaning of the provisions of § 112 (d) (1) and (2) of the Revenue Act of 1928, copied in the margin.[1]

These provisions plainly establish that, in respect of any cash received and not "distributed", there was a taxable gain to petitioner. And, quite as plainly, payment of the debts by petitioner, if made directly by petitioner to the creditors, would not have been

[1](d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

a distribution under the statute; for that contemplates a distribution to stockholders, and not payment to creditors. If, then, petitioner had followed the simple course of retaining in its own hands the sum here in question, and subsequently paying it directly to the creditors, it necessarily would result that liability of petitioner for a tax on the amount of gain could not be avoided. And, obviously, this is the effect of what was done, although circuitously.

The money was received by petitioner and was available for the payment of its debts. It was put into the hands of the stockholders upon the express understanding, as shown by the resolution heretofore quoted, that they would assume all the corporate debts of petitioner, and would enter into a written agreement with petitioner "whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold" the corporate stock and securities which it had received in the reorganization "without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of the Minnesota Tea Company . . ."

In pursuance of the resolution, the stockholders received the money from petitioner to the extent of $106,471.73, not as a distribution for their benefit but as a fund the equivalent of which they were bound to pass on, and did pass on, to the creditors. The conclusion is inescapable, as the court below very clearly pointed out, that by this roundabout process petitioner received the same benefit "as though it had retained that amount from distribution and applied it to the payment of such indebtedness." Payment of indebtedness, and not distribution of dividends, was, from the beginning, the aim of the understanding with the stockholders and was the end accomplished by carrying that understanding into effect. A given result at the end of a straight path is not made a different result because reached by following a devious path. The preliminary distribution to the stockholders was a meaningless and unnecessary incident in the transmission of the fund to the creditors, all along intended to come to their hands, so transparently artificial that further discussion would be a needless waste of time. The relation of the stockholders to the matter was that of a mere conduit. The controlling principle will be found in *Gregory* v. *Helvering*, 293 U. S. 465, 469-470; and applying that principle here, the judgment of the court below is

Affirmed.

Mr. Justice CARDOZO took no part in the consideration or decision of this case.